

GAO

Report to the Chairman, Subcommittee  
on Readiness, Sustainability and  
Support, Committee on Armed Services,  
U.S. Senate

August 1989

# PLANT MODERNIZATION

## DOD's Management of the Asset Capitalization Program Needs Improvement



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The Honorable Alan J. Dixon  
Chairman, Subcommittee on Readiness,  
Sustainability and Support  
Committee on Armed Services  
United States Senate

Dear Mr. Chairman:

This report responds to your November 11, 1987, request that we review the Department of Defense's management and oversight of the Asset Capitalization Program. Although the program offers great potential as a technique for financing capital investment projects, we found that many projects have not achieved expected benefits because of unclear program guidance, inadequate compliance with existing guidance, and inadequate implementation of elements of a sound capital investment management program. We also identified several internal control problems and other factors affecting program execution. The report contains several recommendations to the Secretary of Defense and the service secretaries and matters for congressional consideration.

As arranged with your Office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days from its issue date. At that time, we will send copies to interested committees and other Members of Congress; the Secretaries of Defense, the Air Force, Army, and Navy; and the Director, Office of Management and Budget. We will also make copies available to other parties upon request.

This report was prepared under the direction of Louis J. Rodrigues, Director, Logistics Issues. Other major contributors are listed in appendix II.

Sincerely yours,

Frank C. Conahan  
Assistant Comptroller General

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# Executive Summary

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## Purpose

Between fiscal years 1983 and 1989, about \$5 billion was approved for plant modernization under the Asset Capitalization Program for the Department of Defense (DOD). The Chairman, Subcommittee on Readiness, Sustainability and Support, Senate Committee on Armed Services, asked GAO to evaluate the adequacy of existing guidance; the implementation of the program, including the success achieved and the problems encountered; and the adequacy of internal controls. The Subcommittee also asked GAO to identify any major factors affecting program execution.

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## Background

Industrial fund activities, such as aircraft maintenance depots, shipyards, and public works centers, perform functions of an industrial or commercial nature. In 1983, DOD established the program to modernize plant and industrial equipment at the activities. Under the program, the activities purchase equipment with industrial funds rather than direct appropriations. The activity initially finances the cost of the equipment and then charges its customers, such as fleet commanders, for work performed. It recovers the cost of equipment by including depreciation expense in the charge to its customers.

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## Results in Brief

The program offers great potential as a technique for financing projects needed to modernize the activities' operations. However, many projects have not achieved expected benefits because of unclear program guidance, inadequate compliance with existing guidance, and inadequate implementation of elements of a sound capital investment management program, including management support, well-defined program criteria, and post-investment analyses. GAO identified several internal control problems, including inadequate equipment depreciation accounting and inadequate procedures to ensure the safeguarding of assets. GAO also identified two major factors affecting program execution. First, an increasing number of command- and service-directed projects, as opposed to activity-directed projects, are using a significant amount of program funds. Second, the services believed that if they did not obligate all their equipment funds within the budget execution year they would lose them. As a result, some activities have bought lower priority projects to avoid losing program funds. In addition, the Congress has limited visibility over the costs of large service- and command-directed projects or their impact on the program.

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## Principal Findings

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### Program Guidance Should Be Improved

The Office of the Secretary of Defense has not provided comprehensive guidance for what can be purchased with program funds and existing guidance does not identify its intent for program execution. The Office intended for program funds to be primarily spent on those projects that contribute most significantly toward fulfilling the activities' missions. At the same time, the Office required the services to primarily satisfy their capital investment needs with program funds rather than with other appropriated funds. As a result, the activities spent program funds on a wide range of projects, including some that appear to be inconsistent with the Office's intent. For example, the Watervliet Army Arsenal purchased modular furniture valued at \$500,000 to upgrade the work areas of administrative and overhead organizations.

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### The Asset Capitalization Program Is Not Yet a Sound Capital Investment Management Program

GAO's tests of selected projects showed that the program lacked elements of a sound capital investment management program.

- Until July 1989, the program lacked a functional program manager at the Office of the Secretary of Defense to provide overall program guidance, direction, and oversight and top management involvement at the command and activity level.
- The program lacked a systematic approach to identify investment opportunities, including developing and implementing long-range activity modernization plans.
- The activities did not always follow existing procedures for justifying, reviewing, and approving projects and were slow to acquire and install projects.

Because of these problems, the program had not achieved its full potential in increasing efficiency and productivity. Many projects had achieved fewer benefits than expected or no benefits at all. For example, in June 1986 the Ogden Air Logistics Center received a \$141,000 industrial robot system designed to drill explosive fuel and other components. As of September 1988, the system had only been operated for 4 hours and was stored in a temporary storage building because the Center had not prepared a facility to house it. In addition, the services had not determined the benefits achieved under the program, because the Office left it optional for the services to perform post-investment analyses.

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**Controls Need to Be Strengthened**

Effective internal control systems provide reliable feedback to managers and help them to comply with applicable laws and policies, safeguard assets, and accurately account for revenues and expenditures. Because the activities did not follow controls in some cases, accounting records for depreciation expenses and plant property records were inaccurate, and project files often lacked needed information.

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**Other Factors Affecting Program Execution**

Through the program, the Office intended for the activities to have a greater role in determining specific program requirements. However, increasing service- or command-directed projects for such items as management information systems coupled with congressional funding reductions have restricted the activities' ability to buy needed plant equipment in recent years. This ability is likely to become more limited if further budget reductions continue and such purchases receive higher priority funding.

The Office intended for the activities to request equipment funds only for the amounts that they can obligate within a budget execution year. Furthermore, the Office considered obligation rates as one determinant of the appropriateness of a service's or command's budget allocation. The services believed that if funds were not obligated within the budget execution year, they would lose them. To avoid losing money, some activities bought lower priority items because they were readily available from commercial sources. For example, the Red River Army Depot bought modular furniture rather than a shearing machine, which contributes more to the depot's mission of repairing weapon systems and components.

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**Limited Visibility Over Large Program Purchases**

Because of its concerns, the House Committee on Appropriations, in fiscal year 1987, required the Secretary of Defense to annually report on projects with its budget submission. The report includes the past, current, and budget years. The report did not reflect the total cost of larger service- or command-directed projects over their expected procurement lifetime. For example, the procurement lifetime of the Air Force's depot maintenance management information system is at least 10 years with an estimated cost of about \$275 million. The report to the Congress only identified a 3-year cost of \$51 million for this system.

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**Recommendations**

GAO recommends that the Secretary of Defense

- provide clear guidance to the services stating that program funds should primarily be spent on projects that contribute significantly to fulfilling the activities' missions and
- require post-investment analyses or other measures to determine if anticipated benefits are realized and if changes in program management are needed.

GAO also recommends that the Secretaries of the Army, Navy, and Air Force comply with existing guidance to ensure that the program becomes a sound capital investment management program and that internal control procedures are followed.

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## Matters for Congressional Consideration

The current means of reporting on program purchases to the Congress does not provide sufficient visibility over the expected total project cost. The Congress may want to consider amending its program reporting requirement to require the Secretary of Defense to report the total cost of projects for the entire acquisition period. It may also want to consider whether high-dollar service- or command-directed projects warrant separate funding sources due to their potential short- and/or long-term impact on activity program funding.

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## Agency Comments

DOD generally concurred with GAO's findings and recommendations and outlined actions to be taken by the Office of the Secretary of Defense and the three services. DOD did not agree with the matters GAO raised for congressional consideration. DOD believed that amending the congressional directive requiring the Secretary of Defense to report the total cost of projects over the entire acquisition period could result in duplication of information already provided to the Congress in separate reports. DOD also believed that using separate funding sources for large projects would reduce management flexibility and impair the success of the program because prior to the program, projects identified for separate funding often had difficulties competing directly with other requirements that the services had for appropriated funds.

GAO recognizes that the total cost of some program projects are reported to the Congress. However, the costs are reported to a limited number of congressional committees and are not specifically related to the program. GAO also recognizes that its proposal for separate funding sources would reduce DOD's management flexibility, but believes that the Congress may wish to decide how much flexibility is desirable.

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**Abbreviations**

ACP	Asset Capitalization Program
DOD	Department of Defense
GAO	General Accounting Office
OSD	Office of the Secretary of Defense

# Introduction

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Industrial fund activities, established by the Department of Defense (DOD) with congressional approval in 1949, use working capital funds rather than direct appropriations to finance the cost of goods and services provided to customers.<sup>1</sup> The customers use appropriations and other funds to reimburse these activities for work performed. Industrial fund activities are industrial-type activities, such as Army and Air Force maintenance depots and Navy shipyards, and commercial-type activities, such as Navy public works centers and Air Force laundry and dry cleaning services. During fiscal year 1988, DOD operated 81 industrial fund activities (49 industrial-type and 32 commercial-type) that employed about 277,000 civilian personnel and did about \$24.3 billion worth of business.

Prior to fiscal year 1983, DOD's industrial fund activities had to compete against the procurement of ships, aircraft, and weapon systems when requesting procurement funds for new plant equipment. According to DOD, the activities were generally less than successful in the competition and, as a result, many equipment requirements went unfunded. Over time, much of the equipment at these activities became outdated, inefficient, and less productive than similar equipment in the private sector. To correct this problem and allow for more businesslike operations, DOD established the Asset Capitalization Program (ACP) in fiscal year 1983. The program's objectives are to increase economy, efficiency, and productivity and strengthen the industrial base by modernizing and improving industrial fund operations.

The ACP finances plant equipment acquisitions, modifications, and rehabilitations with a useful life of 2 years or more and costing more than \$5,000.<sup>2</sup> Plant equipment is comprised of two categories—industrial plant equipment and other plant equipment—used, or capable of being used, in developing and manufacturing products or performing services. Industrial plant equipment includes equipment with an acquisition cost of \$5,000 or more that is used to grind, cut, shape, or form metal or other materials. Other plant equipment includes laboratory instrumentation, vehicles, office furniture, and materials-handling equipment. The ACP also finances minor construction projects costing between \$5,000 and \$200,000 with a useful life of at least 2 years and the development of management information projects costing more than \$100,000.

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<sup>1</sup>DOD customers of the industrial fund include fleet commanders, weapon systems managers, DOD agencies, and other elements of DOD involved in logistics support.

<sup>2</sup>Prior to fiscal year 1986, equipment costing more than \$1,000 was considered a capital asset and could be purchased with ACP funds.

Under the ACP, the cost of modernization is shifted to the appropriations of each activity's customers. For example, the Office of the Deputy Chief of Naval Operations for Submarine Warfare would, through its appropriations, help fund equipment used to repair submarines at Navy shipyards. The cost of capital improvements becomes a part of each activity's operating cost and is recovered from its customers through depreciation charges over the useful life of the asset. One basic premise of the program is that as the obsolete machinery is replaced with modern equipment, increased operating efficiencies result which, in turn, should reduce the cost of the product or service to the activity's customers. Another premise of the program was to give activity managers more authority in making procurement decisions.

In approving the ACP, however, the Congress and DOD recognized that depreciation expense alone might not provide the financial resources for capital investment at a level comparable to the private sector. Thus, beginning in fiscal year 1985, the Congress set ACP spending goals and allowed the industrial activities to charge their customers a surcharge to cover the difference between the goal and the depreciation expense. The ACP spending goal was expressed as a percentage of annual revenues generated by the industrial activities. In fiscal years 1985, 1986, and 1987, the ACP targets were 3 percent, 4 percent, and 5 percent, respectively. At DOD's request, the Congress did not establish targets for fiscal year 1988 and beyond.

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## ACP Funding

The advent of the ACP significantly increased the funding for plant modernization in the areas of equipment, minor construction, and development of management information systems. Table 1.1 shows ACP funding since fiscal year 1983 for all DOD industrial fund activities and the four commands and seven activities discussed in this report.

**Table 1.1: ACP Funding for Fiscal Years 1983-1989**

Dollars in millions			
Fiscal years	DOD	Commands reviewed <sup>a</sup>	Activities reviewed <sup>b</sup>
1983	\$306.1	\$268.0	\$48.1
1984	542.8	340.4	77.7
1985	923.3	417.1	132.9
1986	1,002.2	566.9	153.2
1987	957.5	465.4	133.7
1988	724.2	388.3	115.6
1989	547.7	274.4	62.5
<b>Total</b>	<b>\$5,003.8</b>	<b>\$2,720.5</b>	<b>\$723.7</b>

<sup>a</sup>These are the Air Force Logistics Command; the Army Armament, Munitions, and Chemical Command; the Army Depot System Command; and the Naval Sea Systems Command. The commands allocate ACP funds to their activities.

<sup>b</sup>These are the Mare Island and Norfolk Naval Shipyards, Ogden and Sacramento Air Logistics Centers, Red River Army Depot, Watervliet Army Arsenal, and Yorktown Naval Weapons Station. There are an additional 27 activities that we did not review under the four commands.

For the 5 years before the program, DOD spent an estimated \$1.4 billion for equipment at its industrially funded activities. In contrast, DOD was authorized to spend about \$3.2 billion for equipment between fiscal years 1983 and 1987, which represents about a 130-percent growth in authorizations.<sup>3</sup>

## Management Responsibilities

The Office of the Secretary of Defense (Comptroller) has overall responsibility for providing budget and accounting guidance and overseeing budget execution. Similarly, each of the service secretariats have budget and accounting management and oversight responsibilities for their subordinate commands. The commands, however, have the primary responsibility for managing and overseeing different ACPs. The commands, using input from their subordinate activities, must prepare strategic plans and budget submissions, review and approve project justifications and/or economic analyses, develop specific guidance on how to use ACP funds, and oversee subordinate activities' execution of the projects.

The activities have detailed responsibility for managing the program because managers have day-to-day knowledge of the activities' modernization needs, execute the program, and make decisions on proposing

<sup>3</sup>Equipment expenditures are expressed in current dollars.

projects for funding. Under the ACP concept, local activity managers should have maximum flexibility and control over ACP funds.

Each of the activities is responsible for identifying, justifying, and submitting investment requirements through the chain of command. Each is also responsible for executing its approved program by developing procurement specifications and monitoring an item from its procurement through its installation at the activity. In many instances, the activities must rely on other organizations, such as naval regional contracting centers, to contract for ACP purchases.

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## Objectives, Scope, and Methodology

The Chairman, Subcommittee on Readiness, Sustainability and Support, Senate Committee on Armed Services, asked us to assess the management, policies, and funding of the ACP. Specifically, we

- reviewed how the Office of the Secretary of Defense (OSD) established and oversaw the policy for the ACP and assessed management controls at all organizational levels from OSD down to the activities,
- assessed how the services identified ACP investments and how these investments tied into the activities' modernization plans,
- identified the type and quantity of ACP projects procured at selected activities and compared actual operating results to original expectations, and
- identified any major factors associated with program execution.

To accomplish these objectives, we performed detailed audit work at seven industrial-type activities—two Air Force maintenance depots, two Navy shipyards, one Navy weapons station, one Army maintenance depot, and one Army arsenal. The primary mission of the seven industrial-type activities is to repair, manufacture, or store weapons systems for their respective customers. We also performed work at the four commands that had direct management responsibility for the seven activities, the services' headquarters, and OSD. We selected the seven activities based primarily on the amount of ACP funding authorization since the program's inception. The seven activities represented about 14 percent and the four commands represented about 54 percent of the total 100D-wide ACP funding authorized from fiscal years 1983 to 1989. We visited the following organizations:

- Office of the Secretary of Defense, Washington, D.C.;
- Departments of the Army, Navy, and Air Force, Washington, D.C.;
- Army Materiel Command, Alexandria, Virginia;

- Army Armament, Munitions, and Chemical Command, Rock Island, Illinois;
- Watervliet Army Arsenal, Watervliet, New York;
- Army Depot System Command, Chambersburg, Pennsylvania;
- Red River Army Depot, Texarkana, Texas;
- Naval Sea Systems Command, Washington, D.C.;
- Norfolk Naval Shipyard, Portsmouth, Virginia;
- Mare Island Naval Shipyard, Vallejo, California;
- Yorktown Naval Weapons Station, Yorktown, Virginia;
- Air Force Logistics Command, Dayton, Ohio;
- Sacramento Air Logistics Center, Sacramento, California; and
- Ogden Air Logistics Center, Ogden, Utah.

Although the naval aviation depots have received a significant amount of ACP funds, we excluded them from our audit since we recently issued a report on them.<sup>4</sup> As agreed with the requester, we also did not audit commercial-type activities.

To determine how OSD, the services, and commands established program policy and oversaw its execution, we interviewed responsible officials at each organization/activity and reviewed applicable policies, procedures, and pertinent documents. In addition, we reviewed service audit agency reports on the ACP and determined the status of audit findings and recommendations contained in the reports.

To assess how ACP investments are identified and linked to activities' modernization plans, we made limited tests of 28 ACP projects that were funded between fiscal years 1983 and 1987 and compared them to projects identified in the activities' strategic plans.

To identify what projects were funded under the ACP, we reviewed listings of obligated funds (contracted amounts) by federal supply category from the seven activities. In addition, we reviewed detailed listings of specific ACP projects for which funds have been obligated from each of the seven activities by fiscal year and federal supply category (equipment category). We did not verify the accuracy of the databases used by the services to produce the detailed listings; however, we were able to judge their accuracy from our physical inspection of sample items.

From the listings provided, we selected a total of 206 ACP projects for review. To select each project, we considered (1) the amount of reported

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<sup>4</sup>Navy Maintenance: Naval Aviation Depots' Asset Capitalization Program Needs Improvement (GAO/NSIAD-88-134, Apr. 28, 1988).

obligations for equipment, minor construction, and automated data processing equipment and software and (2) whether the projects required a cost or economic analysis according to service guidelines or regulations. We did not scientifically or randomly select items for review. Thus, our results are applicable to the ACP purchases we reviewed and are not representative of all ACP purchases.

For the 206 projects, we determined whether a project file had been established and to what extent it contained pertinent information, such as (1) a project justification or an economic analysis, (2) the status of each project, including the dates of procurement, receipt, and installation, and (3) a post-investment analysis. Through a review of activity records and discussions with ACP officials, we determined the status of the project and, for 82 projects, assessed whether expected project benefits had been achieved. We reviewed 106 projects to determine if they were sufficiently justified. Our tests included reviewing the justification to determine whether the narrative justified the need for the project and whether other alternatives were considered. Through discussions with activity personnel and a review of documentation, we tested the accuracy of such factors as equipment cost projections and work load data used in preparing project justifications.

We compared the results of our work with the key elements of an effective investment strategy as described in a 1973 joint report by the Civil Service Commission (now the Office of Personnel Management), Office of Management and Budget, and GAO entitled Analysis of Productivity-Enhancing Capital Investment Opportunities.

To assess the adequacy of internal controls for the ACP, we reviewed the activities' implementation of the Federal Managers' Financial Integrity Act of 1982, which requires an agency to periodically evaluate internal control systems. We also tested the accuracy of equipment depreciation records and assessed compliance with procedures to ensure that assets were properly recorded in the property records.

To identify major factors associated with program execution, we solicited the views of activity and command officials. We then collected and analyzed data to substantiate their views.

We conducted our review from December 1987 to January 1989 in accordance with generally accepted government auditing standards.

# ACP Guidance Should Be Improved

Essential components of an effective capital investment management program include clear guidance and instructions and compliance with such guidance to ensure that the program is accomplishing its stated objectives. The ACP has weaknesses in these areas. OSD has not provided adequate guidance to the services on how they are to use ACP funds to fulfill the program's intent of focusing ACP funds on those projects that contribute most significantly toward fulfilling the activities' missions. At the same time, OSD required the services to satisfy their capital investment needs primarily with ACP funds rather than with some other type of appropriated funds. As a result, activities spent ACP funds on a wide range of projects, including some that appear to be inconsistent with the program's intent. When OSD guidance was specific, the services and activities did not always follow it and bought such prohibited items as passenger vehicles.

## OSD Guidance Does Not Address Program Plan

When OSD initiated the ACP, it planned for industrial fund activities to use most of their authorized ACP funds to purchase plant equipment that contributes most to the accomplishment of the activities' primary missions. OSD stressed this fact in 1982 testimony before the Congress that lead to the establishment of the ACP. The testimony contained several policy statements that, among other things, (1) required the use of ACP funds rather than appropriated funds to satisfy most capital investment needs, (2) identified defense organizations and equipment items for which ACP funds could or could not be used, (3) provided procedures to be used for accounting and depreciating ACP projects, and (4) established documentation requirements for ACP purchases and follow-up analyses.<sup>1</sup> However, OSD guidance does not specify the program's intent to purchase plant equipment that contributes most significantly to the activities' missions, although it recognizes that ACP funds are the activities' only source for capital investment needs. The guidance also does not define essential equipment.

We spoke with an OSD official who had played a leading role in the formulation, implementation, and overall management of the program since its inception. According to this official, when OSD established the program, it intended for the activities to use most of their allocated ACP funds to buy equipment that contributed most to the accomplishment of the activities' primary missions. He noted that for DOD industrial (repair

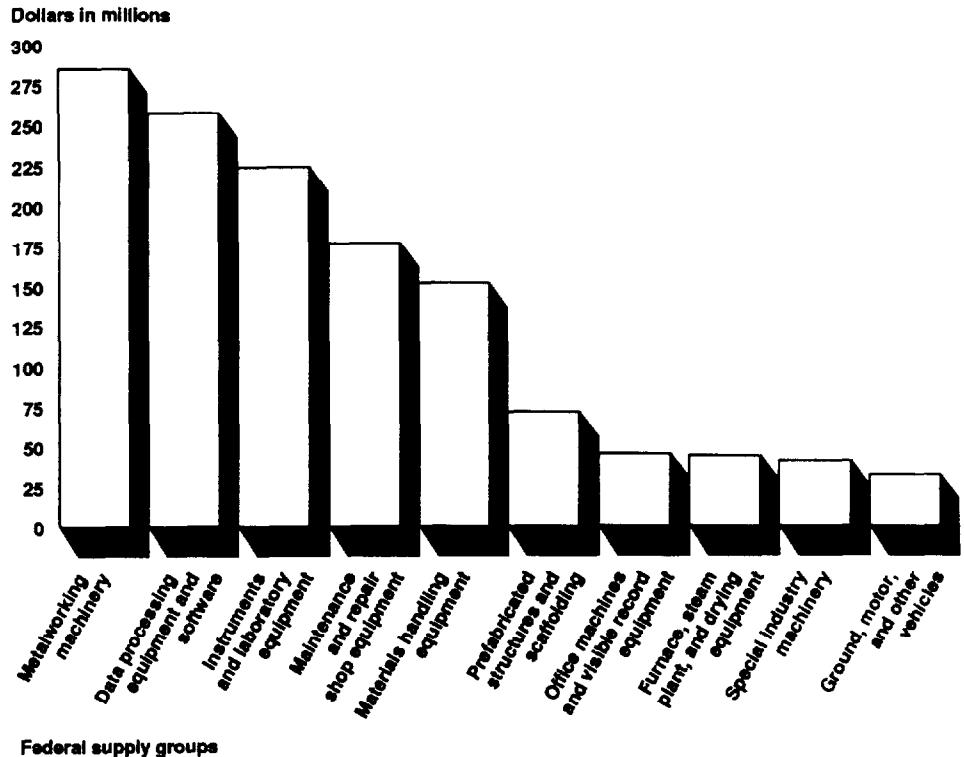
<sup>1</sup>The policy statements were originally contained in a January 14, 1982, memorandum from the Assistant Secretary of Defense (Comptroller) to the services. ACP policy is also contained in DOD guidance 7410.4 R "Industrial Fund Operations," dated April 1982 and 7410.4 "Industrial Fund Policy," dated July 1988. The services have issued various instructions to implement the DOD guidance.

or manufacturing) activities such as the naval shipyards and Army arsenals, this meant that the activities should have purchased plant equipment that directly supported the operation of their repair or manufacturing shops. This type of equipment includes industrial plant equipment (machine tools) and certain types of other plant equipment, such as materials-handling equipment. The official also said that OSD intended for the pre-ACP spending pattern for equipment to continue after congressional approval of the program. The official estimated that a majority of the activities' pre-ACP funding was for direct-support equipment.

Our review of the hearing leading to congressional approval of the program and subsequent congressional reports corroborate the OSD official's views. For example, the fiscal year 1983 House Committee on Appropriations Report on the Defense Budget focuses extensively on industrial plant equipment and in-house industrial activities. The fiscal year 1984 House Committee on Appropriations Report on the Defense Budget again refers to industrial plant equipment purchases when it discusses the ACP.

Since OSD guidance on the program's intent was unclear and the program was to be the primary source of funding for industrially funded activities, the activities under the four commands in our review used ACP funds to buy a wide range of equipment. Figure 2.1 shows the top 10 categories of equipment purchased with ACP funds between fiscal years 1983 and 1987 by those activities.

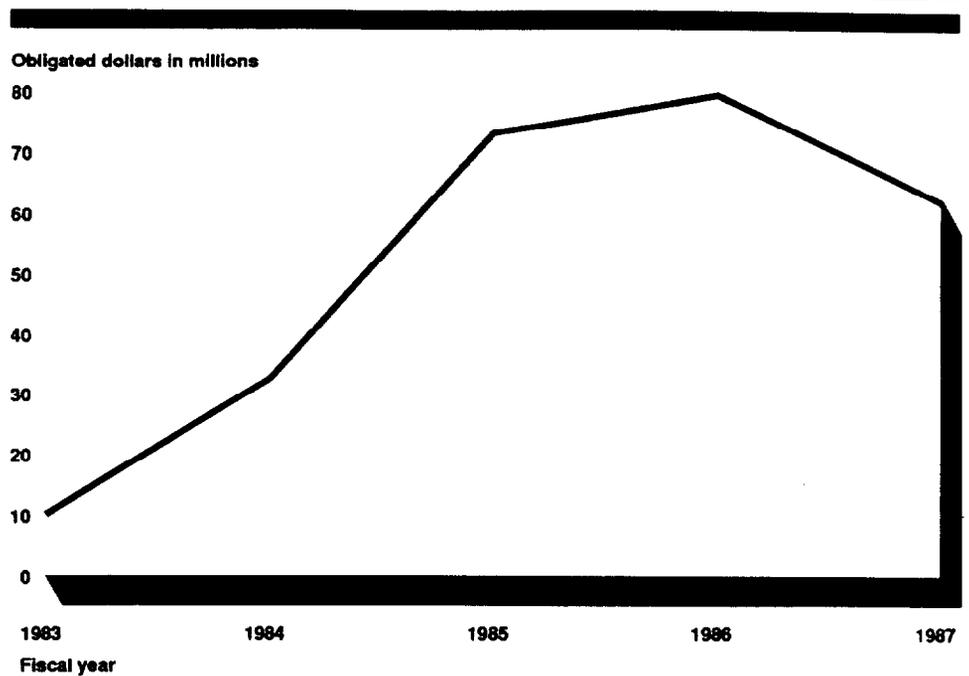
**Figure 2.1: Top 10 Federal Supply Groups of ACP Purchases by the Activities, Fiscal Years 1983-1987<sup>a</sup>**



<sup>a</sup>The Sacramento Air Logistics Center did not provide data for fiscal year 1983.

Although it appeared that the need for most of the equipment purchases we reviewed existed, it is uncertain to what extent the purchases contributed to repair or manufacturing operations. For example, the top 10 equipment categories contained some equipment (automated data processing equipment and software development, prefabricated structures, office machines, and vehicles) that does not appear to be used directly to repair or manufacture items. The automated data processing category includes some computer attachments for industrial machines, but it also includes personal computers that do not directly contribute to repair or manufacturing operations. The office machine category includes such equipment as typewriters and word processors that also do not directly contribute to these operations. Also, some vehicles should not have been procured with ACP funds. Furthermore, these four equipment categories have experienced significant growth. Figures 2.2 and 2.3 show the increased trend of ACP purchases from fiscal years 1983 to 1987 in the automated data processing equipment and software and vehicle categories.

**Figure 2.2: ACP Automated Data Processing Equipment and Software Purchases by the Activities, Fiscal Years 1983-1987<sup>a</sup>**



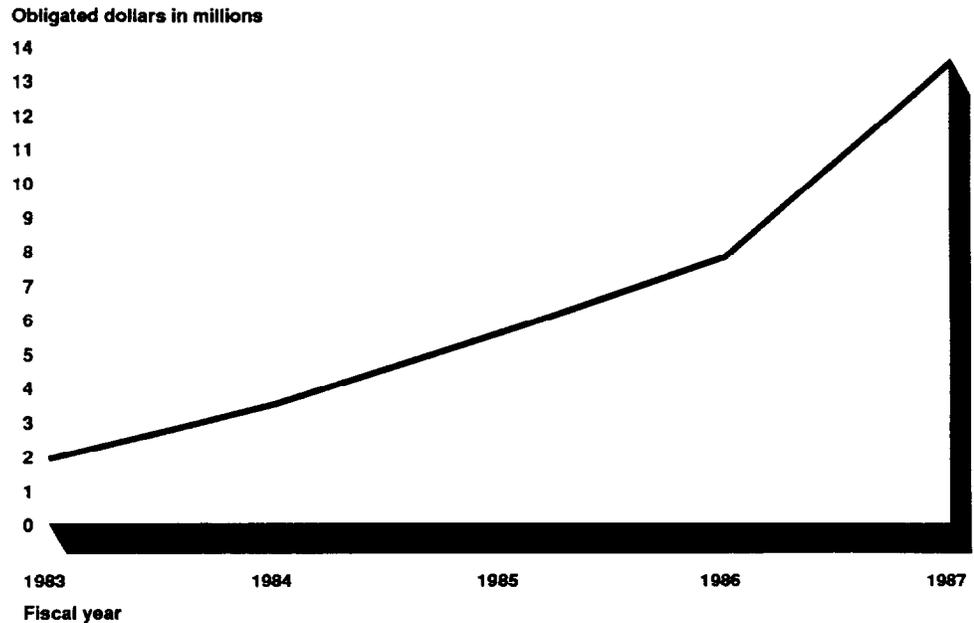
<sup>a</sup>The Sacramento Air Logistics Center did not provide data for fiscal year 1983.

According to OSD officials, a factor contributing to the growth in the automated data processing equipment category was the 1984 congressional initiative for DOD to buy out leased data processing equipment.

In addition to purchases in the top 10 categories, we found other equipment purchases where we are uncertain to what extent they contributed to fulfilling the activities' missions. For example:

- The Yorktown Naval Weapons Station purchased an insect sprayer for \$5,300 in 1984. It used the sprayer about five times in fiscal year 1987 and, as of August 1988, it had not been used at all during fiscal year 1988. Although Yorktown covers over 11,000 acres, an official who supervises the operation of the sprayer said that the primary locations sprayed are the family housing and golf course areas.

Figure 2.3: ACP Vehicle Purchases by the Activities, Fiscal Years 1983-1987<sup>a</sup>



<sup>a</sup>The Sacramento Air Logistics Center did not provide data for fiscal year 1983.

- Yorktown purchased an ice machine in 1984 for about \$1,400 so that field employees would have cold water to drink while working around the base. It also purchased a mobile storage system in 1987 for about \$26,000 to store computer tapes for all business functions on the base, such as payroll, finance, supply, and production.
- The Watervliet Army Arsenal purchased a sofa for \$1,748 in 1983 to upgrade the office of a top arsenal official. Between 1985 and 1987, Watervliet also purchased over \$500,000 of furniture for numerous administrative and overhead organizations at the arsenal.
- The Red River Army Depot purchased two automated drug detection systems in 1986 capable of testing 270,000 urine samples per year, for about \$46,000. This purchase was made after the depot received a message from its parent command that personnel in specifically designated critical positions would be tested for drug use. After procuring the systems, the depot determined that only 180 military and civilian personnel requiring the annual drug test occupied critical positions in the depot. Only three civilian personnel were associated with maintenance, which is the depot's primary mission. The depot determined that one system would more than satisfy its drug testing needs and, therefore, declared the other system excess to its needs.

## Vehicle Guidance Needs Clarification

The OSD guidance on the use of ACP funds for vehicle purchases is unclear and inconsistent with Army guidance. Both OSD and the Army believe their guidance is consistent with congressional intent.

The Conference Report on the fiscal year 1983 DOD Appropriations Act stated that “. . . general purpose passenger vehicles are specifically excluded from purchase through the industrial funds.” In implementing this congressional guidance, OSD directed that such vehicles shall continue to be purchased with appropriated funds. In January 1983, Department of the Army staff obtained clarification on the congressional restriction from a House Committee on Appropriations staff member. According to the Army’s memorandum of the discussion with the staff member, he said that the Committee intended to prevent the purchase of vehicles through the Army’s industrial fund account. The Army’s memorandum indicated that the Committee intended to exclude, from purchase through the industrial funds, vehicles for passenger use (e.g., sedans and buses), general purpose use (e.g., flatbed semi-trailers, truck carryalls, and utility trucks), and special purpose use (e.g., dump trucks and refuse collection trucks).

The Army informed OSD about the Committee staff’s views on the use of ACP funds for vehicles. The Army also drafted its guidance to preclude the purchase of the types of vehicles referred to by the Committee staff. Subsequent OSD guidance on February 17, 1983, to the services on vehicles was more general. The OSD guidance did not permit the purchase of general purpose passenger vehicles that were defined as including, but not limited to, sedans, carryalls, and buses. According to OSD officials, they also discussed the vehicle issue with the Committee and believed that OSD’s guidance complied with the Committee’s intention. However, OSD officials could not provide us with a record of their discussion with the Committee.

Since OSD’s guidance was not totally specific on all the types of vehicles to be excluded, each of the commands interpreted the vehicle restriction differently. The Army’s Depot System Command and Armament, Munitions, and Chemical Command follow the Army guidance that does not permit the acquisition of passenger, general purpose, and special purpose vehicles with ACP funds. The Naval Sea Systems Command guidance excluded general purpose passenger vehicles, defined as sedans, buses, station wagons, and ambulances. The Air Force Logistics Command guidance excluded passenger vehicles that primarily transport personnel, defined as cars, buses, passenger motor vehicle chassis, hearses, and ambulances. Neither the Navy nor the Air Force commands

excluded carryalls in their guidance, although carryalls were specifically mentioned in OSD's guidance. The Mare Island Shipyard, for example, used more than \$270,000 of ACP funds to purchase carryalls. The Army commands' guidance essentially precludes the purchase of most vehicles, whereas the Navy and Air Force commands' guidance is less restrictive.

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## OSD and Command ACP Guidance Not Followed

We also found instances where OSD or command guidance was specific, but was not followed. We identified the following instances where the services did not follow specific OSD or command guidance.

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### OSD Guidance

According to the 1982 OSD memorandum and its implementing instructions, ACP funds cannot be used to purchase, among other things, ships and equipment for tenant activities. On the other hand, activities can use ACP funds to purchase equipment and finance related maintenance and modification costs that are unique to a particular but recurring customer or program, provided the activities charge these costs, if they are significant, to the customer or program.

We found equipment purchases that, although needed, were not made according to established policy. For example:

- Although OSD guidance states that the ACP is to charge specific customers for unique purchases, six Navy shipyards spent \$81 million of ACP funds between fiscal years 1984 and 1988 on unique environmental enclosures needed for a special hull treatment on attack submarines. All shipyard customers were charged rather than only the specific customer. The Naval Sea Systems Command estimates that an additional \$7.7 million is needed to acquire enclosures through fiscal year 1992. As far back as 1984, shipyard representatives believed that the specific customer should pay for the enclosures.

In October 1984, the Command notified the program sponsor, the Deputy Chief of Naval Operations for Submarine Warfare, that in accordance with existing guidance, the shipyards could use ACP funds to buy the equipment and then charge the program's sponsor. The Command, however, noted a \$10 million shortfall in the sponsor's fiscal year 1985 procurement account and requested the sponsor to state how it would reimburse the ACP. In the meantime, the Command notified the shipyards that it was pursuing funding alternatives, but the shipyards could

temporarily use fiscal year 1985 ACP funds to buy needed equipment to meet scheduled hull treatments. Subsequent fiscal year ACP funds have also been used to buy required enclosures. In commenting on a draft of this report, DOD stated that it was appropriate to use ACP funds for the enclosures, but noted that the costs should have been charged to the specific submarine program rather than to all programs.

- Although OSD guidance precludes using ACP funds for tenant activities, the Mare Island Shipyard bought 24 vehicles for its tenant activities, valued at \$150,000 with ACP funds. Furthermore, shipyard officials knew it was improper to do so, but stated that Mare Island had to provide vehicles for all shipyard activities and the ACP was the only available funding source. Although the tenant activities pay the operating and maintenance costs for these vehicles, this use of ACP funds deprived the shipyard of funds for other equipment purchases.
- Although OSD guidance precludes using ACP funds to purchase ships, the Norfolk Naval Shipyard purchased a patrol boat for about \$37,000. According to shipyard officials, the boat was purchased to provide security for the waterfront area.

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## Command Guidance

The Air Force Logistics Command Regulation 66-9, "Depot Maintenance Service, Air Force Industrial Fund Operating Procedures," January 15, 1986, specifies that the ACP is not to fund prototypes for new repair technology. However, the Sacramento Air Logistics Center used about \$3.2 million in ACP funds to cover a funding shortfall in the Productivity, Reliability, Availability, and Maintainability program to procure a prototype stationary radiography system. This program funds new ideas that have potential for a high return on investment or improving operational readiness. ACP funds should not have been used to cover the shortfall in the DOD program. According to Center officials, since no funding alternatives existed when the shortfall occurred, the Center decided to use ACP funds. Center officials believed the project would have been in serious jeopardy if they had not used ACP funds, risking the \$7.4 million in program funds already expended.

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## Conclusions and Recommendations

The ACP needs a clear focus and direction. OSD has not told the services that ACP funds should be used to buy equipment that contributes significantly to fulfilling the activities' missions. The industrial activities should have primarily purchased plant equipment that significantly supported the operations of their repair and manufacturing shops.

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Although much of the equipment purchased between fiscal years 1983 and 1987 contributed significantly to the operations of the repair and manufacturing shops, 4 of the top 10 equipment categories contained equipment that is generally not used to repair and manufacture items. Furthermore, the amount of equipment being purchased in these four categories has increased. The extent to which some other equipment purchases helped to fulfill the activities' missions was questionable.

OSD's guidance to the services is unclear on vehicle purchase exclusions. As a result, the services and activities have applied or interpreted the guidance differently.

We recommend that the Secretary of Defense

- require that ACP funds be used for items that contribute most significantly toward fulfilling the activities' missions, and
- work with the Congress to obtain a clear understanding of its intent to restrict the purchase of general purpose passenger vehicles with program funds.

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## Agency Comments

DOD agreed that emphasis should be placed on acquiring equipment used directly for the activities' primary missions. However, DOD believes that equipment purchases to support those missions should also be authorized under the program. It said that, regardless of whether an ACP project is used on a shop floor or in a production management office, the project should be mission-essential or provide a better economic return than other projects.

Although we agree that support equipment is important to accomplish the activities' missions and that it is appropriate to purchase such equipment, we identified ACP projects that were not clearly in direct support of the activities' missions. DOD stated that by the fourth quarter of 1989, OSD plans to advise the services of the need to place additional emphasis on the use of ACP funds for buying direct mission equipment.

DOD disagreed with our finding that its guidance to the services on the use of ACP funds for general purpose passenger vehicle purchases was unclear and inconsistent with guidance developed by the Army. It also disagreed with our recommendation that existing vehicle guidance be clarified. DOD stated that although the Conference Report on the fiscal year 1983 DOD Appropriations Act excluded general purpose passenger

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vehicles from purchase through the industrial funds, it did not specifically identify what was to be included under this category. DOD indicated that further clarification of congressional intent is required before it can improve its guidance.

We agree that additional clarification of congressional intent is warranted. Therefore, we have revised our recommendation to propose that the Secretary of Defense work with the Congress to define the scope of general purpose passenger vehicles and revise its guidance to the services accordingly.

# ACP Is Not Yet a Sound Capital Investment Management Program

A sound capital investment management program includes (1) top management involvement and support, (2) a systematic approach for identifying investment opportunities, (3) well-defined procedures for justifying, reviewing, and approving projects, (4) prompt implementation of approved items, and (5) post-investment analyses to determine if anticipated benefits are being realized.

The ACP is not yet a sound capital investment management program. It has had inadequate management involvement and support, ineffective procedures for identifying and acquiring beneficial investment projects, inadequate reviews of proposed projects, inadequate processes for monitoring the status of projects, insufficient staffing, and a lack of feedback on what the program has accomplished. Many ACP projects were inadequately justified and reviewed, others were slow to be acquired and installed, and few or no benefits had been achieved for several projects. The services have taken steps to address some of the ACP problems.

## Inadequate Management Involvement and Support

Top management involvement and support is one of the prerequisites for a successful capital investment strategy. Such involvement and support is demonstrated through clear program guidance, well-defined organizational responsibilities, and sufficient staffing resources for program management. Management involvement and support could be improved at all levels—OSD, service headquarters, commands, and the activities.

As demonstrated in the previous chapter, OSD and the services have developed limited or unclear guidance on how the program should be managed. Some commands and activities are still operating under draft guidance and instructions. Other commands developed guidance that was not approved until several years after the program began. For example, naval ordnance and weapon stations are still operating under draft guidance from its parent Naval Sea Systems Command. The Command, however, has developed formal guidance for its shipyards, although the guidance was not issued until May 1987, over 4-1/2 years after the ACP began.

According to an OSD official who has been associated with the ACP since its inception, one factor contributing to inadequate program guidance has been unclear organizational responsibilities. The official stated that a typical DOD program is run by an OSD functional manager who provides overall program guidance, direction, and oversight that would logically be placed under the Assistant Secretary of Defense (Production and Logistics). At the time of our review, OSD had no functional manager for

the ACP. Instead, OSD (Comptroller) staff handled program management responsibilities and viewed their role as a financial advisor to functional program managers. The OSD staff generally only provided budget and accounting guidance for the program and collected and reviewed ACP financial data.

The OSD official also stated that the OSD staff could not provide effective program oversight, because of the limited data on the ACP program currently available at the OSD level. For example, OSD does not collect information on (1) the type and quantity of equipment purchased under the ACP and (2) how many equipment buys are service- or command-directed versus activity-directed. Currently, this information can only be obtained by contacting each of the 81 industrially funded activities, which can be a time-consuming process. For example, it took the commands between 2 and 3 months to respond to our request for data on the quantity and value of equipment, by federal supply group or class, annually purchased by their respective activities. The OSD official believed that having this information is essential for a program manager to function effectively.

The activities also have unclear organizational responsibilities. For example, the Norfolk Naval Shipyard program coordinator was only responsible for managing nonautomated data processing equipment. However, the individual's responsibilities included ensuring that budgetary limits were not exceeded on all ACP purchases. According to the coordinator, he could not execute his responsibilities since he had no control over funds spent for data processing equipment.

Although the ACP has increased the level of funding for equipment, the personnel assigned responsibility at each command for executing the program is not commensurate with those funding levels. The Naval Sea Systems Command, Ordnance and Ships, and Air Force Logistics Command ACP coordinators had many other collateral duties. As a result, the ACP had not received adequate attention. The coordinators had not visited the activities to determine how the program has been progressing or whether funds are being spent in the most efficient manner.

According to the Naval Sea Systems Command, Ordnance, ACP coordinator, her ACP responsibilities were collateral to her other duties, and she did not have the time and had limited travel funds to visit the activities. She said that she was the only staff member responsible for monitoring the activities program execution, which included reviewing project proposals.

Prior to 1986, the project review function was in another organization and was handled by as many as 10 staff members with collateral duties located at the Naval Weapons Support Center in Crane, Indiana. However, because the other ordnance activities were concerned that Crane could receive preferential treatment, the Command assumed the review function without transferring the staff. In February 1989, we were informed that the Naval Sea Systems Command, Ordnance, ACP coordinator was assigned to the program on a full-time basis as of October 1988.

Also, the Watervliet Army Arsenal had several directorates and offices responsible for the ACP. No one person within these offices had the ACP as their primary responsibility.

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## Lack of Systematic Approach to Identifying Investment Opportunities

The process of identifying investment opportunities is one of the most important aspects of a successful program. A systematic approach to search for and identify investment opportunities can go beyond the routine replacement of worn-out equipment and result in the redesign of an entire work process. Comprehensive planning can identify ways that capital improvements can eliminate current bottlenecks in work flow and achieve significant gains in productivity and turnaround times. According to a February 1988 Logistics Management Institute Report<sup>1</sup> on depot maintenance, such planning was not occurring. For the most part, new equipment ideas focused on replacing current equipment, not on identifying new ways of doing business through existing or new technology. According to Navy officials, however, the Naval Sea Systems Command has begun to focus its industrial engineering resources at shipyards on identifying where work process improvements can be made.

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## Lack of Technological Direction

Technological direction is a key element in identifying investment opportunities. According to the Logistics Management Institute report, technological direction helps to provide a context in which to integrate many individual modernization projects that are proposed to solve specific operational problems at DOD maintenance depots. The report said that without such a direction, projects tend to (1) be evaluated without considering their interactions with one another, (2) simply replace old equipment with new equipment of the same type, and (3) ignore large-

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<sup>1</sup>David Glass and Lawrence Schwartz, Depot Maintenance Modernization, Logistics Management Institute (Bethesda, Md.: Feb. 1988).

scale, multiyear efforts that are usually a part of effective technological strategies. The report concluded the following:

“The depots do not have a technological direction for modernization and, therefore, their capital-investment decisions are made on a case-by-case basis. As a result, opportunities for major improvements may be missed.”

The capital investments made at the Tobyhanna Army Depot, Tobyhanna, Pennsylvania, helped lead the Institute to its conclusion. Although Tobyhanna had just installed a large automated storage and retrieval system, other depots were finding that several small retrieval systems could be much more productive. According to the Institute, without a clearer understanding of the long-term depot modernization requirements, the decision to build a centralized system may or may not have been correct. The report, however, noted that the services had initiated several actions to provide improved technological direction for its depot modernization programs.

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### Many ACP Projects Not Contained in Strategic Plans

The commands have recognized that a systematic approach to capital investment planning is desirable. Each of the commands require their activities to have long-range (3 to 7 years) strategic plans that identify, among other things, facility and equipment requirements. In the Army, these plans are used to justify budget requests.

We found that 12 of 28 ACP projects were not in the activities' strategic plans. For example, only 3 of 10 ACP projects (30 percent) approved by the Air Force Logistics Command were contained in the Sacramento Air Logistics Center fiscal year 1986 strategic plan, and 9 of 18 (50 percent) ACP projects approved by the Naval Sea Systems Command, Ordnance, were in the Yorktown Weapons Station's fiscal year 1986 strategic plan.

According to Air Force officials, what is actually purchased with ACP funds is not based on the strategic plan. The officials further stated that purchases should be based on the strategic plan if it is to be successfully implemented and they plan to have future ACP budget allocations reflect what is in the plans. According to the Naval Sea Systems Command, Ordnance, ACP coordinator, it was not surprising to find only 50 percent of the items in the plan due to changing priorities and the shifting of projects. The coordinator said that the command had not actually compared purchases to those in the plan since it assumed the review responsibility because she did not have the time, given her other duties and responsibilities.

Two audit organizations reported similar findings. For example:

- Preliminary Army Audit Agency findings of capital equipment purchases at four Army depots showed that of 388 ACP projects funded for fiscal years 1987 and 1988, which were valued at about \$43 million, 200 (52 percent) were not in the activities' strategic plans. At one depot, the agency found that only 1 of 46 projects was in the plan.
- A March 1988 Air Force Logistics Command's Inspector General report<sup>2</sup> found at least 17 equipment purchases that did not appear on 3 air logistics centers' strategic plans. The report concluded that the strategic plan was not used to guide the centers' current equipment needs or to buy priority equipment.

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## Procedures to Justify, Review, and Approve Projects

A good investment strategy includes standard procedures to justify, review, and approve proposed investments. This strategy helps to ensure that capital resources are used on those projects with the greatest potential benefits. The OSD memorandum to the services requires that project justifications be adequately documented and include justification and economic analyses to ensure that a post-investment analysis and audit can be performed. According to other OSD guidance, care should be taken to ensure that equipment that is bought for economic reasons should provide the greatest return on investment through increased productivity and reduced costs, and activities should be prepared to provide evidence of both proposed and actual benefits. For equipment that is purchased for noneconomic reasons, adequate justifications need to be prepared. Our work and recent Army Audit Agency, Air Force Audit Agency, and Naval Audit Service reviews found that compliance with existing procedures needs to be improved.

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## Existing Command Procedures

Each of the commands has different procedures or criteria for justifying, reviewing, and approving projects. Although the procedures and criteria differ, certain basic elements are included to economically justify projects. Command guidance states that project justifications should include a cost comparison of alternatives considered versus the cost to maintain the status quo. The cost analyses should include a comparison of costs of the present and proposed equipment, such as direct and indirect labor costs, and maintenance and repair costs. Other factors considered in the justifications are the acquisition and transportation costs of

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<sup>2</sup>Management of Depot Industrial Equipment, Office of the Inspector General, Headquarters, Air Force Logistics Command, Wright-Patterson Air Force Base, Ohio (PN 88-17, Mar. 6-24, 1988).

the proposed equipment and the cost of removing the old equipment. The justifications should also sufficiently describe the present operating method and the problems creating the need for the equipment, and explain how the proposed procurement will resolve the problems.

Although the services require that all projects be justified, some do not have to be economically justified. For example, the Naval Sea Systems Command does not require economic justifications on projects that are essential to perform an activity's missions. Similarly, projects that are needed for pollution abatement and safety reasons do not need to be economically justified.

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## Justifications

Reliable ACP project justifications are vital to the program's credibility. We found that many project justifications did not explain why the item was needed and did not contain supportable analyses. As a result, the justification process has not ensured that only valid, beneficial projects are acquired under the program.

We reviewed 106 projects to assess their justifications. We found no evidence that 11 projects had ever been justified. For the remaining 95 projects, 39 justifications, or 41 percent, were inadequate for such reasons as improper work load projections and equipment costs and inadequate consideration of alternatives to purchasing equipment. For example:

- The Watervliet Army Arsenal prepared two justifications inconsistently, one several years before the items' acquisition and one about 1-1/2 years after contract award for another item. In one case, the justification was not updated to reflect the latest work load and cost data. Watervliet had acquired two profiling machines in August 1983, each costing about \$235,000. The estimate was based on a justification made 4-1/2 years before the acquisition, and had not been updated. In the second case, the justification was not prepared until after the purchase was made. Watervliet had prepared a justification in March 1985 for three bed milling machines costing about \$1.4 million under a contract awarded in September 1983.
- The Yorktown Naval Weapons Station's justification did not consider the alternative of repairing existing equipment when deciding to buy a new crane truck valued at about \$197,000. Yorktown officials said that it would have cost about \$30,000 to repair a defective part on the truck and that current Navy criteria allows for the replacement of the truck

after 10 years. Therefore, since the truck was over 10 years old, rather than repair the part, they bought a new truck.

Various DOD audit organizations also disclosed justification problems. For example:

- According to the Naval Audit Service,<sup>3</sup> two east coast shipyards overstated the anticipated economic benefits for 20 planned projects valued at \$14 million using inappropriate production, general, and administrative overhead rates. It identified five industrial plant equipment project proposals with estimated acquisition costs of over \$4.6 million that should not have been approved. The Naval Sea Systems Command canceled these projects and assigned the shipyards the responsibility of certifying the accuracy of project justifications before they were submitted to the Command for review and approval. According to Command officials, these projects would have been rejected under its current guidance.
- According to the Air Force Audit Agency,<sup>4</sup> the Sacramento Air Logistics Center did not adequately justify equipment items for 35 projects with estimated costs totaling \$58.8 million. The operating personnel who bought the equipment could not provide adequate support documentation for any of 35 equipment projects. The Center concurred and stated that, in the future, project folders will contain required documentation which, at a minimum, will contain cost analyses based on valid data that fully supports the project justification.
- According to preliminary Army Audit Agency findings, Army depots did not prepare economic analyses for 289 of 411 equipment projects reviewed for fiscal years 1986 to 1989 valued at \$43 million. The depots exempted the 289 projects from economic analyses because the Depot System Command had issued guidance that conflicted with Army Regulation 11-28 requiring such analyses. When the analyses were prepared, the depots seldom addressed alternatives other than maintaining the status quo or purchasing new equipment. The Audit Agency concluded that, as a result, the depots incurred unnecessary costs when buying equipment.

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<sup>3</sup>Management of Industrial Plant Equipment Acquisitions at Selected East Coast Naval Shipyards. Naval Audit Service (087-S-88, Apr. 13, 1988).

<sup>4</sup>Budgeting for the Asset Capitalization Program in Depot Maintenance Services. Air Force Industrial Funds, Air Force Audit Agency (452-7-02, Oct. 14, 1986).

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## Project Review and Approval

According to service and command regulations, the commands and activities should consider organizational goals and economic benefits when evaluating and approving ACP projects. In evaluating projects, the commands and/or activities should validate the data used in the project justifications. Our work and various recent audit reports showed that commands and activities routinely approved projects without adequately reviewing the justifications.

At 3 of the 4 commands, we reviewed 31 project justifications that met the criteria for command review. The command review was limited and projects were approved on a perfunctory basis. Proposals were rarely disapproved, or challenged, even when justifications contained incorrect economic analyses. For example, based on our review of eight shipyard projects valued at about \$2.5 million, we found that the Naval Sea Systems Command did not verify whether the justifications contained accurate work load data for four of the projects valued at about \$1.4 million. The Command is now requiring shipyard comptrollers to certify the accuracy of project justifications and plans to periodically visit the shipyards to review the comptrollers' work.

The Army Audit Agency and Naval Audit Service found similar project review and approval problems. For example:

- According to preliminary Army Audit Agency findings, the Depot System Command approved equipment projects without proper economic analyses and support for work load data. The Agency concluded that about \$22.8 million of equipment projects were approved based primarily on unsupported work load data. The Command agreed with the findings and said that actions would be taken to ensure that future projects would be properly justified.
- According to the April 1988 Naval Audit Service report, the Naval Sea Systems Command did not effectively review project justifications when its approval was required. Consequently, it approved two projects totaling \$1.5 million that should have been canceled because they were based on outdated work load forecasts and inadequate economic justifications.

The Audit Service also found that the shipyards did not adequately review and approve projects. It concluded that the absence of a systematic review and approval process at the Command had indirectly resulted in inadequate review and approval at the shipyards.

## Approved Projects Not Promptly Implemented

To obtain benefits as early as possible, a sound capital investment management program needs to have well planned and timely project implementation. However, we found significant time lapses between the time a project was received and when the equipment was either installed or became operational. We examined 106 ACP projects—some of which contained several pieces of equipment—valued at \$43.3 million to determine whether the equipment was operational at the activities by the time of our visit. Of these projects, 10 should have been operating, but were not. Two other projects were not fully operational. For example, the Norfolk Naval Shipyard received a plate roll machine valued at about \$273,000 in June 1987. It did not install the machine until April 1988, and had not started operating it as of September 1988. According to Norfolk shipyard officials, the reasons for the delay were (1) a lack of proper oil to operate the machine, (2) electrical code violations that needed to be corrected, and (3) a lack of adequately trained machine operators.

In addition, the activities had received other equipment for ACP projects that should also have been installed, but was not due to various problems. For example:

- The Ogden Air Logistics Center received a \$300,000 chromatograph mass spectrometer in July 1987 to measure the contents of aged propellant fuel. The Center stored the spectrometer in an empty building that was to be remodeled to house the equipment. At the time of our visit—about 13 months after the Center had received the item—the building had not been remodeled and the spectrometer had not been installed or utilized. In addition, the manufacturer's warranty had expired. The Center was using the old equipment to meet fuel analysis requirements.
- The Mare Island Shipyard received a heat treating furnace in April 1986, costing about \$160,000. At the time we completed our work in August 1988, the Shipyard did not expect the furnace to be installed until October 1988. Also, Mare Island received an 8-foot shear in June 1985, valued at about \$170,000, but did not install it until May 1988. According to Mare Island officials, problems concerning the laying of foundations for the equipment delayed the installation of both items. According to Mare Island officials, the installation delays were atypical, since the majority of equipment items purchased were installed and operating within 90 days of delivery.

DOD agreed that some projects had delayed implementation but did not believe this indicated a systemic problem. We were unable to determine

how widespread this problem is due to the lack of data, such as installation dates in the activities' project files (see ch. 4).

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## Program Benefits Are Generally Not Measured

An effective capital investment program contains a mechanism for analyzing the success or failure of investment projects and for collecting data so that management can make better investment decisions in the future. This mechanism, called a post-investment analysis, has not been adequately implemented by the services. OSD has not issued a formal requirement for the services to perform post-investment analyses. OSD guidance only states that records must be maintained so that a post-investment analysis can be performed.

The Navy did not require its activities to perform any post-investment analyses. None of the Navy activities we reviewed had performed any post-investment analyses because of insufficient staffing, and they believed that the analyses have little value. Air Force activities had not performed any prior to 1987 because officials viewed them as manpower intensive and questioned their benefits. Although Army activities had performed post-investment analyses, those analyses have shown, for the most part, that many project benefits were overstated primarily because of optimistic work load projections. As a result, neither OSD nor the services know what benefits the ACP has produced. In some cases, they do not know if the equipment purchased has actually been used.

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## Some Projects Reviewed Are Not Achieving Anticipated Results

We reviewed 82 projects valued at about \$40 million at the seven activities to determine whether anticipated results had been achieved. We found that 27 projects valued at about \$30 million had not achieved anticipated results. For example:

- The Ogden Air Logistics Center received a \$141,000 industrial robot system in November 1986 designed to drill explosive propellant fuel and other missile components. When the system was received, a contractor temporarily installed it, operated it for about 4 hours, and the Center accepted it. At the time the Center accepted the robot system, it had not prepared a facility to house the system. As of September 1988, the robot system was still sitting idle in a temporary storage building. According to Air Force Logistics Command officials, the Center accepted the robot system because it would have had to pay the contractor to store the equipment if it had not accepted it. The officials said the system is now operational.

- The Watervliet Arsenal purchased three bed mills in fiscal year 1985 for about \$1.4 million. The Arsenal expected the machines to achieve benefits of about \$271,000. According to the post-investment analysis performed by the Arsenal for July 1, 1986 through June 30, 1987, the actual benefits were about \$199,000, or \$72,000 less than estimated. The reason for the lower benefits was due to differences between estimated work load projections and the actual use of the equipment.

The Army Audit Agency made similar observations regarding projects not achieving expected results. The Agency found that the Army had estimated the benefits for 26 of 44 items at \$5.2 million, but the items had achieved benefits of only \$2.8 million, or \$2.4 million less than anticipated. The benefits were less than expected primarily because actual work loads were less than estimated. Other reasons were attributed to calculation errors in the cost factors of the project justification and equipment not used as intended.

We found 55 projects valued at about \$10 million that had achieved their expected benefits. For example, at the Ogden Air Logistics Center, a \$419,000 vertical turret lathe used to repair landing gear and brake and wheel components appeared to have generated benefits. Center officials have determined actual cost benefits of the new lathe at about \$1.2 million. Furthermore, they said the efficiency and accuracy of machining the components had improved. The lathe can refurbish six B-52 wheels in the time it used to take to complete one. Also, the Center replaced a 1970 jig boring machine used to repair aircraft landing gears with a newer model costing \$662,000. According to shop personnel, repairing main landing gear for C-5 aircraft now takes 4-1/2 less days than with the old machine.

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## Conclusions and Recommendations

The ACP offers great potential as a technique for financing industrial fund activities' modernization programs and increase efficiency and productivity. However, it does not have all the essential elements of a sound capital investment management program. The ACP needs stronger management involvement and support; a more systematic approach for identifying projects needed to satisfy technology and strategic planning requirements to include work process improvements; better procedures to justify, review, and approve ACP projects; better planning and timing for project implementation; and improved procedures to measure program benefits.

The services have taken some steps to address the various ACP problems. The Air Force has started to improve its strategic planning process, and both the Army and Air Force have started to perform post-investment analyses. The Navy has begun to focus its industrial engineering resources at shipyards on identifying where work process improvements can be made. We believe these are steps in the right direction.

We recommend that the Secretary of Defense place additional management emphasis on the ACP. Specifically, the Secretary should require post-investment analyses or other measures to determine if anticipated benefits are being realized and if changes in program management are needed.

We also recommend that the Secretaries of the Army, Navy, and Air Force direct their respective commands to

- comply with existing guidance to ensure that capital investments are consistent with the activities' strategic plans, projects are implemented in a timely manner, and post-investment analyses are being performed; and
- assign sufficient personnel to manage and execute the program.

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## Agency Comments and Our Evaluation

DOD agreed that the ACP program is not yet a sound capital investment management program, and management involvement and support and a more systematic approach to identifying investment opportunities were needed. DOD also agreed that better compliance with existing procedures to justify, review, approve, and implement projects was needed.

In response to our recommendation, DOD centralized overall program guidance and oversight within the Office of the Assistant Secretary of Defense (Production and Logistics) on July 5, 1989. DOD plans to issue guidance by the end of December 1989 requiring post-investment analyses on projects. Each of the services plans to emphasize to its respective commands and activities the need to comply with existing guidance to ensure that capital investments are consistent with the activities' strategic plans; projects are implemented in a timely manner; and post-investment analyses are being performed. In addition, the services plan to

assign more personnel to the program to ensure that guidance is followed and that proper review and analysis is conducted.

DOD also agreed that post-investment analyses have generally not been conducted, but noted that during the past 2 years the services' budget exhibits have displayed cost savings resulting from the program. Therefore, DOD expressed the view that our statement that neither it nor the services know what benefits the ACP has produced was misleading.

We agree that some post-investment analyses have been performed, and, in some instances, individual projects have produced benefits. For the most part, however, commands and activities did not perform post-investment analyses. As a result, neither OSD nor the services can attest to the program's success from a total program perspective.

# Internal Controls Need to Be Strengthened

Effective internal controls help managers comply with applicable laws and policies, safeguard assets, and accurately account for revenues and expenditures. Effective internal control systems also provide management with reliable feedback that can help ensure program goals and objectives are met. Because control techniques for the ACP were not followed in some cases, we found that depreciation and property records and project files were inaccurate and inadequate.

The accuracy of depreciation accounting is important not only from an internal control perspective, but also because it affects the activities' industrial fund rates. To finance the ACP, depreciation expenses are included in the rates charged to each activity's customers for performing work, such as maintenance of aircraft, ships, and wheeled vehicles. A surcharge is added to the rate to make up the difference between the depreciation and the desired ACP funding level.

## Internal Control Requirements

The Federal Managers' Financial Integrity Act of 1982 placed increased emphasis on the need for effective internal controls. The act requires agencies to evaluate internal control systems and periodically report the results. Agencies are to make the evaluations according to Office of Management and Budget guidance and are to assess whether the systems meet the objectives of internal controls and comply with GAO standards.

According to our Standards For Internal Controls In The Federal Government, internal controls help to ensure that the use of resources complies with existing laws and regulations to safeguard against waste, loss, and misuse. Internal controls also provide a reliable database to evaluate the use of resources. Good internal controls help to facilitate management objectives by serving as checks and balances.

## Depreciation Records Are Inaccurate

With the exception of the Watervliet Army Arsenal, the other six activities we reviewed each had several ACP projects that were either not depreciated or depreciated inaccurately. Of 105 projects we reviewed valued at about \$39 million, we found 21 projects costing \$16.1 million that were not being depreciated. In most cases, the equipment had been used for several months. For example, at the time of our visit, the Mare Island Shipyard was not depreciating a management information system costing \$98,000 that should have been depreciated since January 1986. This occurred because the organization responsible for management

information systems had not assigned responsibility for submitting records to the Shipyard's accounting department to initiate depreciation.

We also found 41 projects costing \$10.3 million that were depreciated inaccurately because (1) projects were depreciated at incorrect values or (2) depreciation expenses were recorded late. As a result, the rates charged by the activities to their customers were overstated or understated in some cases.

These problems are caused by a lack of or inadequate procedures at the command or activity levels or a failure by the activities to follow procedures. For example, the Red River Army Depot incorrectly depreciated seven items because of inadequate procedures to verify that the actual costs of equipment was recorded on depreciation records. The Depot had recorded estimated costs rather than the actual costs. In one case, the Depot had recorded the value of a computer-assisted design system as \$28,000 when the actual cost was \$1.6 million. The Depot agreed to take corrective action. In addition, the Depot notified its command headquarters that command guidance did not include a procedure to verify that depreciation figures were accurate. The command concurred and subsequently issued supplemental instructions requiring all depots to establish a verification procedure for equipment acquisitions.

Problems in properly accounting for depreciation have also been cited in other evaluations. For example:

- The Army Audit Agency found that depreciation charges at the Tobyhanna Depot were not accurately reported in financial records and statements. For approximately \$10.6 million of new equipment received at the Depot, depreciation expenses were understated by about \$250,000 because of delays in posting the receipt of new equipment.
- The Air Force Logistics Command's Inspector General reported in March 1988 that equipment costing over \$33 million had not been depreciated at the Sacramento Air Logistics Center. In two cases, depreciation started before the equipment was installed. It also stated that more than 40 items had been fully depreciated, even though they had a substantial service life left.

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## Property Inventory Records Are Inaccurate

Activities are to maintain property records for the inventory for which they are accountable to safeguard against potential theft, damage, or loss of valuable resources. Three activities' inventory or property control records did not list several equipment items in our sample. Some of these items had been used for some time. For example:

- The Norfolk Naval Shipyard had an ACP project for 34 terminals, printers, and modems costing \$186,000. None of the equipment associated with the project was on Norfolk's inventory control records. Norfolk had received the equipment in 1985—over 2 years before our visit. According to officials, the Shipyard did not record the equipment because it was not certain which office was responsible for preparing the required paperwork.
- The Red River Army Depot property records did not contain information on \$9.5 million of equipment purchased as part of a contract for a new light armored vehicle maintenance facility. According to Depot officials, the Corps of Engineers was responsible for contracting out for the construction of the facility and the procurement of equipment. However, the officials said that the Corps never provided it with listings of the equipment that had been purchased. Furthermore, they did not follow up to find out what the Corps had purchased. After our review, Red River obtained the equipment listings, verified that the equipment was purchased, and began recording the items on its property records. Corps officials said they were late in providing the equipment listings because they had experienced problems with the contractor. They said that the contractor did not provide them with timely equipment listings and, because the contractor's records were in such poor condition, determining the price and location of the equipment purchased was a lengthy process.
- The Watervliet Army Arsenal had accepted two lathes in August and September 1986 costing \$360,000. As of July 1988, the Arsenal had not recorded this equipment on its property records because of untimely processing of required paperwork.

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## Project Files Are Incomplete

Internal control standards require written evidence of all pertinent aspects of the transactions of an agency. Also, the documentation should be complete and accurate and should trace the transaction and related information from when it is first anticipated, while it is in process, and after it is completed. This standard is essential to managers in controlling their operations and to auditors in analyzing operations.

Many project files, however, did not have complete information on the history of each project and some required documents were missing, incomplete, or undated. In some instances, documents were unsigned, which did not provide assurance that they had been submitted for review and approval by the responsible organizations. For example, the files for planned purchases of industrial plant equipment should contain a signed certificate of nonavailability from the Defense Industrial Plant Equipment Center certifying that the activity checked to see if the equipment could be obtained from the Center. Some files either did not contain a certificate or contained one that was undated or unsigned. Also, information such as the date the item was received, installed, and became operational was not always evident. Many files did not have receipt or invoice documents showing the item's cost. In most cases, we had to rely on officials to remember project status information.

Project files were incomplete because the activities either lacked specific guidance on what documentation needed to be in the files or had inadequate guidance. OSD guidance is general and states that the basis for capital equipment purchases must be adequately documented at the activity level so that post-investment analyses and audits can be performed. The Departments of the Army and the Navy also had not developed specific guidance on the kind of information to maintain in project files.

The Air Force had developed guidance, but it was confusing. One section of the guidance required project files to contain sufficient information to show what the item cost, why it is needed, whether there are economic advantages, and when and where the item is installed. However, another section of this guidance said that the files should contain documentation to support post-investment analyses and audits and the files' contents should be commensurate with the equipment cost. According to the Air Force Logistics Center, Office of the Inspector General's March 1988 report, each air logistics center interpreted the guidance differently and the information contained in the files varied greatly between centers and even within centers. Of 60 equipment items the Inspector General reviewed, 20 files did not contain the minimum required information, and 13 files could not be located.

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## Conclusions and Recommendations

The ACP program managers need to comply with existing internal controls and develop additional procedures. The activities had inadequate and inaccurate accounting records for depreciation expenses and plant property. As a result, equipment items valued in the millions were not depreciated and some equipment could not be accounted for. Many of

the ACP project files did not contain sufficient information on equipment cost, receipt, installation, and use because the activities either lacked specific guidance on what should be contained in the files or had inadequate guidance.

We recommend that the Secretary of Defense develop guidance on the minimum documentation required to be maintained in ACP project files. We also recommend that the Secretaries of the Army, Navy, and Air Force direct their respective commands to (1) comply with existing internal control procedures, (2) develop procedures to verify that actual costs of equipment are recorded on depreciation and plant property records, and (3) ensure that internal control procedures are being followed.

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## Agency Comments and Our Evaluation

DOD agreed that the program contained the internal control weaknesses identified in our report. It said that each of the services plans to review and revise, as necessary, their directives to (1) ensure compliance with existing internal control procedures and (2) verify that actual costs of equipment are recorded on depreciation and property records. The services also plan to ensure that internal control procedures are followed.

DOD partially agreed with our recommendation to develop guidance on the minimum amount of documentation to be maintained in ACP project files. DOD said that documents contained in ACP files should not duplicate documents contained in files maintained in military contracting offices. We agree that project documentation should not be duplicated. However, the ACP files should be properly annotated to identify where pertinent documents for each project are maintained for ready access.

# Other Factors Affecting Program Execution

Under the original ACP concept, the activities were to implement their programs since they would best be able to determine their modernization needs. Since the program's inception, however, two factors have affected the activities' ability to execute the program in a manner consistent with OSD's original intent to focus program funds on those projects that contribute most significantly toward fulfilling the activities' missions. First, nondiscretionary purchases—projects directed by service commands or headquarters—when coupled with congressionally mandated budget reductions, have limited the activities' buying power. Second, OSD's intent is to have the activities request ACP funds for the amounts that are to be obligated in the budget execution year and to use obligation rates in determining future ACP budget allocations. The services perceived this to mean that they had to obligate the funds within the budget execution year or lose them. This has resulted, in some cases, in the services funding lower priority projects.

In addition, many of the nondiscretionary projects require a significant amount of ACP funds, yet key congressional committees have limited visibility over the total amount of funds associated with these projects.

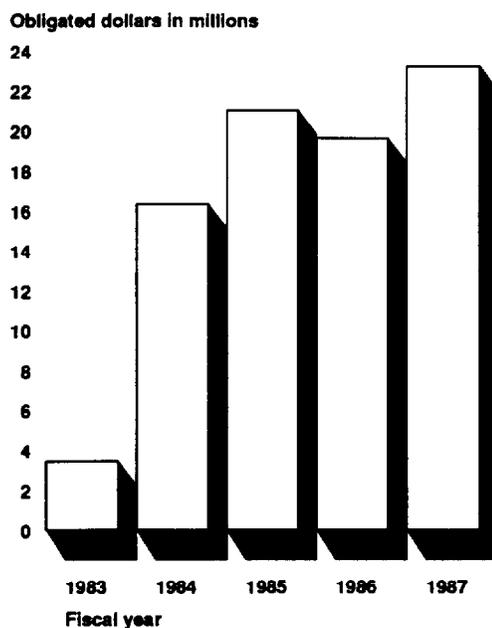
## Nondiscretionary Project Purchases Reduce Activities' Buys

Although the activities have some discretion in spending their annual fund allocations, activities must also fund many nondiscretionary purchases. Figure 5.1 shows that the amount of nondiscretionary obligations at the seven activities we visited increased from about \$3.5 million in fiscal year 1983 to about \$23.2 million in fiscal year 1987.

The data in figure 5.1 are conservative because we found projects that had been reported, but the values of the projects had been understated. For example, at the Mare Island Shipyard a security system that was reported at about \$310,000 actually cost \$529,000.

Officials at the Red River Army Depot, Mare Island Naval Shipyard, and Sacramento Air Logistics Center indicated that their discretionary buying power has been affected by (1) the increasing number of nondiscretionary projects that receive higher funding priority and (2) congressionally mandated budget reductions. If the ACP continues to be a target for additional budget reductions and nondiscretionary requirements continue to receive higher priority funding, these activity officials do not see their discretionary buying power as improving. The following discusses the conditions at the three activities:

**Figure 5.1: Nondiscretionary ACP Purchases by the Seven Activities, Fiscal Years 1983-1987**



- The Red River Army Depot expended about \$12.3 million, or 30 percent, of its \$40.7 million budget authority for three nondiscretionary projects from fiscal years 1983 through 1987. For fiscal year 1989, about \$1.5 million was authorized for Red River, all of which was spent on nondiscretionary automated data processing equipment projects.
- The Mare Island Naval Shipyard used about \$25 million of \$88 million, or about 28 percent of its ACP funds, for nondiscretionary items between fiscal years 1983 and 1987. Two projects (special hull treatment enclosures for submarines and nuclear refueling equipment) comprised about \$19 million, or 76 percent, of the total nondiscretionary purchases. According to the ACP coordinator, as a result of nondiscretionary purchases, the amount of ACP funds dedicated to machine tool purchases had been reduced from about 60 to 20 percent. In future years, the situation at Mare Island is expected to continue. For fiscal years 1988 through 1992, the Shipyard expects that about 32 percent of its budget will be dedicated to nondiscretionary purchases, including a \$3.3 million production management information system.
- The Sacramento Air Logistics Center spent about 19 percent of its authorized budget, from fiscal years 1983 to 1987, on nondiscretionary projects. According to the ACP coordinator, although the impact of nondiscretionary purchases on the program was insignificant in the past

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this situation has changed. For fiscal years 1988 through 1991, the Center expects that about 61 percent of its budget will be for nondiscretionary purchases.

Information we obtained on corrective actions taken by the Naval Air Systems Command in response to our April 1988 report further illustrates the impact of nondiscretionary purchases. According to Command officials, increasing requirements for information systems, such as the Rapid Acquisition of Manufactured Parts, Computer Aided Design 2, and Engineering Data Management Information and Control Systems, raises questions as to the adequacy of ACP funding levels.<sup>1</sup> They said that projected depot funding levels for fiscal years 1989 and beyond are insufficient to support both the management information system requirements and capital investment requirements developed by the depots. The Command suggested that either additional ACP funds be made available or consideration be given to fund information system requirements from sources other than the ACP.

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## Program Affected by Need to Obligate Funds Within Budget Execution Year

Under the ACP, the activities can carry unobligated equipment funds forward until they are spent. According to OSD officials, activities are to request ACP funds for the amounts that are to be obligated in the budget execution year. Furthermore, the commands' obligation rates are one determinant of the appropriateness of their ACP budget allocation. The services perceived this to mean that they were to obligate their ACP funds within the budget execution year or lose them, and they communicated this to their respective commands and activities. To avoid losing budget allocations, some activities substituted lower priority items for higher priority items because they were more readily available from commercial sources.

OSD began measuring obligation rates in fiscal year 1987, after the Congress became concerned about large unobligated balances in the services' industrial funds. OSD and the service comptrollers have used obligation rates to measure program execution. Accordingly, OSD reduced the budgets for the commands and activities we visited by about \$30.9 million between fiscal years 1986 and 1988. For example:

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<sup>1</sup>The Command projected that the Navy would need about \$37 million for the Engineering Data Management Information and Control System between fiscal years 1991 and 1994. About \$25 million, or 68 percent of the total, would be provided by the Command's industrially funded activities.

- The Air Force Logistics Command reduced the Sacramento Air Logistics Center's budget authority by about \$2.4 million for fiscal year 1986 because the Center was unable to obligate the funds within the fiscal year. In fiscal year 1987, the Air Force Logistics Command required a 100-percent obligation rate by July 1, 1987, for all the activities. Obligation rates commandwide were 64 percent in fiscal year 1983, 57 percent in 1984, 70 percent in 1985, 81 percent in 1986, and 100 percent in 1987.
- The Army Audit Agency found problems with the execution of program funds at the Depot System Command. The Agency found that the Army reduced the Command's budget authority by \$13.7 million and \$12 million in fiscal years 1987 and 1988, respectively, because the Command had not met its obligation goals. The Army Audit Agency data showed that only 53 percent of the fiscal year 1988 budget authority had been obligated by March 31, 1988, although it was the Command's goal to have 75 percent obligated by that date.

As we reported in April 1988, the Navy did not have its budget reduced due to low obligation rates because it reported commitments rather than obligations. For example, at the end of fiscal year 1987, the Norfolk Naval Shipyard reported that 99 percent of its \$47 million budget authority had been obligated when only 3 percent was actually obligated. According to Norfolk officials, the difference represents funds that were committed but not obligated. OSD concurred with our recommendation that the Secretary of the Navy should report actual ACP obligations to the Secretary of Defense and the Congress. Effective with the amended fiscal years 1988 and 1989 biennial budget, the ACP amounts reported are actual obligations.

To avoid losing funds, some activities substituted lower priority items for higher priority items because they were readily available from commercial sources. For example:

- In fiscal year 1986, the Red River Army Depot had about \$1.1 million that became available for obligation in August 1986 because it canceled a project. With 2 months remaining in the fiscal year, Red River purchased lower priority items, such as modular furniture for about \$17,000 in lieu of higher priority items, such as a shearing machine, robotic welder, and grinder. The depot did not have sufficient time remaining in the fiscal year to contract for these items.
- In fiscal year 1987, the Sacramento Air Logistics Center shifted over \$8 million that could not be obligated from higher to lower priority items. Because of time constraints, Sacramento could not obligate funds for 8 of the top 25 equipment items on its priority list. Some of the eight items

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included test sets, blast booths, and forklifts. The Center, therefore, substituted lower priority items that were commercially available. Officials were unable to identify the lower priority items that were substituted.

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### Factors Affecting the Activities' Ability to Obligate Funds

Activity officials cited various factors that affected their ability to obligate funds. The factors included preparing required paperwork to initiate procurement actions, and timely action by procurement activities to enter into contractual agreements.

OSD believed that the activities were not preparing the required paperwork until after the fiscal year began, resulting in the procurement packages being sent to the procurement function late in the fiscal year. Preparing paperwork early is important because of the time required by the procurement function to contract for some of the equipment. When we discussed the actions taken as a result of our April 1988 report on naval aviation depots with Navy officials, they said that the depots could obligate all of their funds within the budget execution year if they prepared required paperwork 12 to 18 months before the budget execution year. Although OSD's view about advanced paperwork is legitimate, according to activity officials, some procurements require more than 1 year, regardless of the amount of advanced planning.

According to activity officials, the procurement functions occasionally appear to give less urgency to equipment purchase requests because ACP equipment funds do not expire. Procurement functions, therefore, emphasize the completion of contract work for items with expiring funds.

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### Actions Taken to Help Ensure Funds Are Obligated

Some Army and Air Force commands and activities have taken or are planning actions, other than buying lower priority items, to help ensure the funds are obligated within the budget year. For example:

- The Army Depot System Command introduced the concept of contracting for equipment subject to the availability of funds. In March of each fiscal year, the Command provides its activities with funding authority estimates. The activities then begin developing their equipment priority lists and are also allowed to prepare contracts for the equipment items. However, the contracts will only be awarded if and when funds are received at the beginning of the next fiscal year. This process allows the depots to have contracts prepared for obligation at

the beginning of the fiscal year and saves time in the solicitation, bid review, and contract award process.

- The Air Force Logistics Command, in March 1988, notified its air logistics centers of new planning requirements to improve the obligation process at central procurement activities. Beginning with fiscal year 1989, the centers are to prepare documents to rank, justify, and plan for all equipment requirements for the next 2 fiscal years.

## Limited Visibility Over Large Nondiscretionary Purchases

A significant amount of ACP funds were associated with several nondiscretionary projects. However, key congressional committees have limited visibility over the amount of funds directed toward these purchases. Some of the large dollar items purchased by the activities have included prefabricated structures for the Navy's special hull treatment program valued at about \$90 million, equipment for the Air Force's depot maintenance management information system costing more than \$275 million, and the Army's automated storage and retrieval systems with an estimated cost of \$88.5 million.

The Congress recently became concerned about its visibility of ACP purchases. In October 1987, the House Committee on Appropriations directed OSD to provide, beginning with its fiscal years 1988 and 1989 biennial budget estimates, annual budget exhibits showing how ACP funds are used, particularly for large dollar volume items in excess of \$1 million.

We reviewed the exhibits OSD provided the Congress in response to its concern. In accordance with the guidance, the exhibits only cover the fiscal years 1987 and estimated 1988 and 1989 time period. The exhibits do not provide the total cost of a project over its entire acquisition period. This information would be useful to the Congress in deciding the impact of the items' procurement on the ACP and the industrially funded activities. For example:

- Navy exhibits show about \$9.7 million in fiscal year 1987 for the special hull treatment enclosures. However, the Navy spent a total of about \$46 million prior to fiscal year 1987 and about \$36 million during fiscal years 1987 and 1988 for these enclosures. The Navy plans to spend another \$7.7 million between fiscal years 1989 and 1992 for a total project cost of about \$90 million.
- Army exhibits show that the Depot System Command plans to spend about \$36 million between fiscal years 1987 and 1989 for automated

storage and retrieval systems for its maintenance depots. The Command, however, spent \$23 million prior to fiscal year 1987 for the system and plans another \$29.5 million after fiscal year 1989. The total cost of the system is expected to reach about \$88.5 million.

- Air Force exhibits show that the cost of its Depot Maintenance Management Information System is about \$51 million for fiscal years 1987 through 1989. Air Force data show that the total cost of this system through fiscal year 1999 is expected to exceed \$275 million.

## Conclusions

Two major factors have affected ACP execution. First, although OSD intended for the activities to have a greater role in determining specific program requirements, increasing service- or command-directed projects for such items as management information systems coupled with congressional funding reductions have restricted the activities' ability to buy needed plant equipment in recent years. This ability is likely to become more limited if the program continues to be a target for further budget reductions and service- or command-directed purchases continue to receive higher priority funding.

Second, OSD intended for the activities to request equipment funds only for the amounts that they can obligate within a budget execution year. Also, OSD considers obligation rates as one determinant of the appropriateness of a service's or command's budget allocation. Therefore, the services perceived this to mean that if funds were not obligated within the budget execution year, they would lose them. To avoid losing money, some activities bought lower priority items because they were readily available from commercial sources.

According to activity officials, two major factors affecting their ability to obligate funds are the preparation of required paperwork to initiate procurement actions and timely action by procurement activities to enter into contractual agreements. OSD officials, however, believe that the activities could do a better job of preparing advanced paperwork and, as a result, the activities could obligate their funds. Some Army and Air Force commands and activities have taken or are planning actions to prepare advanced paperwork and help ensure that funds are obligated within the budget year.

In addition, in fiscal year 1987, the House Committee on Appropriations required the Secretary of Defense to annually provide information on projects with its budget submission because of concerns over the visibility of the program. The report submitted to the Congress covers only a

3-fiscal year period; therefore, the report did not reflect the total cost of larger service- or command-directed projects with an expected procurement lifetime in excess of 3 fiscal years.

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## Matters for Congressional Consideration

The current means of providing the Congress with information on ACP purchases does not provide sufficient visibility over the use of ACP funds. The Congress might consider amending its ACP exhibit reporting requirement to include having OSD report the total cost of ACP projects over the entire project cycle. The Congress might also consider establishing a ceiling on the amount of ACP funds used to purchase high-dollar, service- and command-directed projects due to their potential short- and/or long-term impact on activity ACP funding, and allow the services to compete for funds above the ceiling in the procurement appropriations process.

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## Agency Comments and Our Evaluation

DOD agreed that program execution has been affected because the commands and activities need to obligate ACP funds within the budget execution year.

DOD agreed that nondiscretionary project purchases have reduced the activities' discretionary buying power. However, DOD noted that this is not bad, if service- or command-directed ACP purchases result in increased commonality, compatibility, and efficiency.

DOD also agreed that current budget exhibits submitted to the Congress generally do not identify the total cost of projects through their completion. However, according to DOD, it followed established budget procedures that were agreed to by the Congress, and in several cases, the total cost of large, multiyear projects was provided to the Congress in separate reports. Therefore, DOD believed that implementing our suggestion to have the Congress amend its program requirement for the Secretary of Defense to report the total cost of long-term ACP projects would not result in significant benefits.

We do not believe that the separate reports referred to by DOD provide the Congress with sufficient oversight of the current and planned use of program funds on large, nondiscretionary projects because they (1) are not sent to all congressional committees and subcommittees with oversight of DOD operations, (2) do not specifically identify the total costs of projects through their completion, and (3) do not identify specific costs associated with the program. We believe that DOD could, with minimum

effort, modify the existing ACP budget exhibits to include the suggested information.

DOD disagreed with our suggestion that the Congress consider whether high-dollar service- or command-directed projects should have separate funding sources. DOD believed that implementing our suggestion would impair the activities' ability to plan, budget, and execute an organized program to modernize and maintain an industrial base, since pre-ACP experience showed that plant equipment purchases could not successfully compete with other items funded from the services' procurement appropriations.

We agree that equipment purchases could not always successfully compete with other items funded through the procurement appropriations process and there is the need to maintain some management flexibility on the use of ACP funds. As a result, we revised our matter for congressional consideration to call for a ceiling on the amount of ACP funds used to purchase high-dollar, service- and command-directed ACP projects rather than for totally separate funding sources. We recognize that establishing such a ceiling would still reduce management flexibility on the use of ACP funding. On the other hand, it would give the Congress greater oversight and control over the increasing amount of funds directed toward such purchases.



# Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMPTROLLER OF THE DEPARTMENT OF DEFENSE  
WASHINGTON, DC 20301-1100

MAY 18 1989

Mr. Frank C. Conahan  
Assistant Comptroller General  
National Security and International  
Affairs Division  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense response to the General Accounting Office (GAO) draft report "PLANT MODERNIZATION: DOD's Management of the Asset Capitalization Program Needs Improvement," dated March 22, 1989 (GAO Code 391608, OSD Case 7941).

The Department generally agrees with most of the findings and recommendations contained in the draft GAO report. However, the Department does not concur with the findings and recommendations relative to the clarification of existing guidance concerning acquisition of vehicles and the definition of a unit. In both cases, the ambiguity in existing guidance is the result of issuances emanating from sources outside the Department of Defense. Consequently, the Department takes the position that clarification should be the responsibility of the organizations that originated the guidance, particularly when the guidance is intended to have Governmentwide applicability.

The Department also does not support the GAO position on the two matters for congressional consideration. Amendment of the reporting requirement to compel the Secretary of Defense to report the total cost of Asset Capitalization Program projects over the entire acquisition period would result in duplication of reports. The use of separate funding sources for selected Asset Capitalization Program projects would impair the success of the program because equipment identified for separate funding would compete directly with other requirements that the Military Services have for appropriated funds.

Detailed comments concerning the specific findings and recommendations in the draft GAO report are enclosed. The Department appreciates the opportunity to comment on the draft GAO report.

Sincerely,

  
Clyde O. Glaister  
Comptroller

Enclosure

GAO DRAFT REPORT - DATED MARCH 22, 1989  
(GAO CODE 391608) OSD CASE 7941

"PLANT MODERNIZATION: DOD'S MANAGEMENT OF THE ASSET  
CAPITALIZATION PROGRAM NEEDS IMPROVEMENT"

FINDINGS AND RECOMMENDATIONS TO BE ADDRESSED IN THE  
DOD RESPONSE TO THE GAO DRAFT REPORT

\* \* \* \* \*

FINDINGS

● **FINDING A: Background: Plant Modernization Program.** The GAO observed that industrial fund activities, such as aircraft maintenance depots, shipyards, and public works centers, perform functions of an industrial or commercial nature. The GAO explained that in 1983, the Department of Defense established the program to modernize plant and industrial equipment at the activities. According to the GAO, under the program, activities purchase equipment with industrial funds rather than direct appropriations. The GAO reported that the activity initially finances the cost of the equipment and then charges its customers, such as fleet commanders and weapons systems managers, for work performed. The GAO pointed out that the activity recovers the cost of equipment by including depreciation expense in the charge to its customers. According to the GAO, the objectives of the program are to bring about more businesslike operations while increasing economy, efficiency, and productivity and strengthening the industrial base. (p. 2, pp. 10-14/GAO Draft Report)

**DoD Response:** Concur

● **FINDING B: OSD Guidance Does Not Address Program Plan.** According to the GAO, when the DoD initiated the Asset Capitalization Program (ACP), the plan was to have industrial fund activities use the majority of their authorized ACP funds to purchase plant equipment that contributes most to the accomplishment of the mission of the activity. The GAO referred to 1982 testimony of the Office of the Secretary of Defense, which led to the establishment of the ACP. The GAO explained the DoD testimony contained 33 policy statements that, among other things, (1) required the use of ACP funds rather than appropriated funds to satisfy most capital investment needs, (2) identified Defense organizations and equipment items for which ACP funds could or could not be used, (3) provided procedures to be used for accounting and depreciating ACP projects, and (4) established documentation requirements for ACP purchases and follow-up analyses. The GAO found, however, that the DoD guidance does not specify the program intent to purchase only essential equipment, although it recognizes that the ACP is the

Now on pp. 2, 8-9.

Now on pp. 2-3, 14-18.

only source of funding of capital investment needs for the activity. The GAO observed that, since the DoD guidance on the program intent was unclear and the program was designated to be the primary source of funding for industrially funded activities, the activities used ACP funds to buy a wide range of equipment. The GAO verified that the need for most of the equipment purchased did exist. However, the GAO questioned the extent to which the equipment purchased contributed to repair or manufacturing operations. The GAO concluded that four of the top ten equipment categories that ACP funds were used to purchase contained equipment that is generally not used in the repair and manufacture of items. The GAO indicated that, furthermore, purchase trends in these four categories have been on the increase. (p. 2-3, pp. 21-28/GAO Draft Report)

**DoD Response:** Partially Concur. Although emphasis should be placed on the purchase of equipment that is generally used in the direct mission of the activities, industrial fund operations also require support equipment, which contributes to the accomplishment of the mission. The purchase of support equipment should continue to be permissible under the Asset Capitalization Program.

Management Information Systems, for example, have the potential to improve the utilization of resources, the scheduling of work load, material control, and productivity in general. In addition, automated systems for management, personnel, and financial information are necessary to the maintenance of economy and efficiency in the activities' overhead areas. This results in lower costs to customers and makes a direct contribution to the accomplishment of the industrial fund mission. The automated data processing acquisitions include computer-aided design and computer-assisted manufacturing systems and software maintenance tools. As weapon systems become more sophisticated, the depot equipment required to repair them becomes more highly technical. As a consequence of this, requirements for automated data processing are likely to increase.

Regardless of whether an ACP project is to be utilized on a shop work floor or in a production management office, the fact is that, to be selected, it should be mission essential or provide a better economic return than other projects.

● **FINDING C: Vehicle Guidance Needs Clarification.** The GAO reported that the DoD guidance to the Services on the use of ACP funds for vehicle purchases is also unclear and is inconsistent with guidance developed by the Army. The GAO pointed out that both the DoD and the Army consider their guidance to be consistent with the congressional intent. The GAO referred to the Conference Report on the FY 1983 DoD Appropriations Act, which stated that "...general purpose passenger vehicles are specifically excluded from purchase through the industrial funds." According to the GAO, the Army met with the House

Appendix I  
Comments From the Department of Defense

Appropriations staff to obtain clarification on the congressional restriction and was told that the Committee intended to exclude, from purchase through industrial funds, vehicles for passenger use, general purpose use, and special purpose use. The GAO observed, however, that the DoD guidance was not as restrictive as the Army guidance on the purchase of vehicles with ACP funds. As a result, the GAO found that the activities it reviewed had spent about \$30 million of ACP funds to buy passenger, general purpose, and special purpose vehicles. In addition, the GAO identified one activity that was not reviewed, the Naval Facilities Engineering Command, which may have spent up to \$176 million of its \$222 million ACP budget allocation for FY 1983 through FY 1987 on transportation equipment, predominantly vehicles. The GAO concluded that since the DoD guidance does not specify all the types of vehicles to be excluded, each of the commands interpreted the vehicle restriction differently. (p. 2-3, pp. 28-30/GAO Draft Report)

Now on pp. 19-20.

**DoD Response:** Nonconcur. In the Appropriations Committees' Conference Report on the FY 1983 appropriations bill (Report No. 97-980), the conferees simply excluded "general purpose passenger vehicles." No further clarification was provided in the report language. Even if Army representatives did obtain an informal interpretation from one of the congressional appropriations committees, further clarification of congressional intent is required before the Department of Defense will be in a position to improve its guidance to all industrial fund activities. The application of unnecessarily restrictive guidance to activities such as the Navy Public Works Centers could result in increased costs to the Government.

See comment 1.

The GAO citation of the Naval Facilities Engineering Command for the purchase of vehicles is very misleading in this context. That command's industrial fund activities are the Navy Public Works Centers. These centers have a primary mission, which is neither manufacturing nor depot maintenance. Their primary mission is to provide utility services, facilities maintenance, and transportation support at various shore facilities. Consequently, they are very different from the majority of the activities actually reviewed during the audit. Since vehicles are essential to the performance of the Public Works Centers' primary mission, it is appropriate that a significant portion of their ACP funds was devoted to transportation equipment.

• **FINDING D: OSD Definition of a Unit Needs Clarification.** The GAO reported that the DoD guidance states that ACP funds can be used to purchase equipment items with a unit cost of \$5000 or more (changed from \$1000 in 1985) and such items are to be capitalized and depreciated. The GAO explained that equipment items with a unit cost less than \$5,000 are to be expensed. The GAO found that, because of unclear DoD guidance on what constitutes a unit in determining the unit cost of an item, the various Services and activities interpreted the definition of a unit differently and, as a result, depreciation or expensing of

equipment items have been treated inconsistently. At three activities, the GAO noted that individual items costing less than \$5,000 were combined to form a unit or system costing more than \$5,000. According to the GAO, in June 1988, the DoD drafted guidance to clarify the concept of a unit. However, the GAO described the guidance as incomplete because it does not define the concept of a unit. (p. 2-3, pp. 30-32/GAO Draft Report)

See comment 2.

**DoD Response:** Nonconcur. The DoD follows the governmentwide criteria for the capitalization of assets, as established by the GAO and published in standard D20, "Depreciation and Amortization," in Title 2 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies. Current DoD guidance relative to industrial fund purchases of equipment states that items that meet the capitalization criteria shall be budgeted as ACP purchases. Those that do not meet the criteria are properly treated as expense items. Neither the GAO guidance nor the DoD implementation of the GAO guidance uses the term "unit." If the GAO perceives that there is a need for a standard definition of the term "unit" for capitalization purposes, it would appear that such a definition should be developed by the GAO for use on a Governmentwide basis.

• **FINDING E: DoD and Command ACP Guidance not Followed.** The GAO reported that, based on a 1982 DoD memorandum and its implementing instructions, ACP funds cannot be used to purchase (among other things) aircraft and equipment for tenant activities, but ACP funds can be used to purchase equipment and finance related maintenance and modification costs that are unique to a particular customer or program, provided the costs, if significant, are charged to the customer or program. The GAO found equipment purchases that, while needed, were not made in accordance with the established policy.

Furthermore, the GAO explained that the Air Force Logistics Command Regulation 66-9, Depot Maintenance Service, Air Force Industrial Fund Operating Procedures, dated January 15, 1986, specifies that the ACP is not to fund prototypes for new repair technology. The GAO found, however, that the Sacramento Air Logistics Center used about \$3.2 million in ACP funds to cover a funding shortfall in the DoD Productivity, Reliability, Availability, and Maintainability Program to procure a prototype stationary radiography system. (p. 2-3, pp. 32-35/GAO Draft Report)

Now on pp. 2-3, 20-21.

**DoD Response:** Partially Concur. The GAO identified a number of examples of ACP purchases that that were inconsistent with established policies. However, some illustrations in the draft report do not reflect improper ACP purchases. For example, the submarine hull treatment enclosures (pp. 33-34) were viewed as equipment which would support a number of different classes of submarines. Therefore, it was appropriate to use ACP funds to acquire them although the costs should have been charged to the

submarine overhaul program through depreciation in lieu of charging to all programs.

● **FINDING F: Inadequate Management Involvement and Support.**

The GAO emphasized that top management involvement and support is one of the prerequisites for a successful capital investment strategy. The GAO observed that such involvement and support is demonstrated through clear program guidance, well-defined organizational responsibilities, and sufficient staffing resources for program management. The GAO concluded that management involvement and support could be improved at all levels--at the DoD [Office of the Secretary of Defense], at Service headquarters, at the commands, and at the activities themselves.

The GAO found that, with the exception of the 33 policy statements in the January 14, 1982, DoD memorandum, and the April 1982 and July 1988 implementing instructions, neither the DoD nor the Services have developed much guidance on how the ACP should be managed. For example, the GAO pointed out that management had provided no guidance to the commands and activities that:

- explains how to prepare sound project justifications and sound economic analyses;

- identifies how many and what type of projects should undergo post-investment analyses; and

- indicates what tests should be made to ensure the project justification is accurate and that various alternatives have been adequately identified and considered.

According to the GAO, existing guidance focuses primarily on budget formulation and accounting practices and procedures. (p. 4, pp. 35-42/GAO Draft Report)

**DoD Response:** Partially concur. As the GAO recognized in a footnote on page 22 of the draft report, the Office of the Secretary of Defense, the Services, and the commands have provided guidance for industrial fund activities. This guidance does cover the subject of how to perform economic analyses. However, more specific guidance may be necessary in certain areas.

● **FINDING G: Lack of Systematic Approach to Identifying Investment Opportunities.** The GAO described the process of identifying investment opportunities as one of the most important aspects of a successful capital investment program. The GAO explained that a systematic approach to search for and identify investment opportunities can go beyond the routine replacement of worn-out equipment or the redesign of an entire work process. The GAO pointed to comprehensive planning as a way to identify what capital investments can eliminate current

Now on pp. 2-3, 24-26.

See comment 3.

Now on pp. 2-4, 26-28.

bottlenecks in work flow and achieve significant gains in productivity and turnaround times. The GAO found, however, that such planning was not occurring. The GAO observed that, for the most part, new equipment ideas came from the production floor and focused on replacing current equipment, not on new technology. (The GAO did note that the Navy has begun to focus its industrial engineering resources at shipyards on identifying where work process improvements can be made.) (p. 4, pp. 43-46/GAO Draft Report)

**DoD Response:** Concur

● **FINDING H: Procedures to Justify, Review, and Approve Projects.** The GAO described a good investment strategy as including standard procedures for justifying, reviewing, and approving proposed investments. The GAO explained that this strategy helps to ensure that capital resources are used on those projects with the greatest potential benefits. The GAO reported that the DoD memorandum to the Services requires that project justifications be adequately documented and include justification and economic analyses to ensure that a post-investment analysis and audit can be performed. The GAO further reported the DoD guidance states (1) that care should be taken to ensure that equipment that is bought for economic reasons should provide the greatest return on investment through increased productivity and reduced costs, and activities should be prepared to provide evidence of both proposed and actual benefits and (2) that the guidance also provides the equipment purchased for non-economic reasons should have adequate justifications prepared. The GAO concluded that this review, along with recent Army Audit Agency, Air Force Audit Agency, and Naval Audit Service reviews, showed that compliance with existing procedures-needs to be improved. (p. 4, pp. 47-54/GAO Draft Report)

Now on pp. 2-4, 28-31.

**DoD Response:** Concur

● **FINDING I: Implementation of Approved Projects.** The GAO observed that activities need to have well planned and timely implementation to obtain benefits as early as possible. The GAO found, however, significant time lapses between the time a project was approved, ordered, and received and when the equipment was either installed or became operational. The GAO examined 106 ACP projects--some of which contained several pieces of equipment--valued at \$43.3 million, on which the equipment had been installed at activities by the time of the GAO visit. The GAO pointed out that ten of these projects should have been operating, but were not. In addition, the GAO noted that an additional two projects were not fully operational. Furthermore, the GAO observed that the activities they visited had received other equipment for ACP projects that should have been installed, but was not due to various problems. (p. 4, pp. 54-56/GAO Draft Report)

Now on pp. 2-4, 32-33.

**DoD Response:** Concur. The Department of Defense agrees that instances of delayed implementation exist. However, the Department does not consider this to be an indication of a systemic problem.

● **FINDING J: Program Benefits are Generally Not Measured.** The GAO observed that an effective capital investment program contains a mechanism for analyzing the success or failure of investment projects and for collecting data so that management can make better investment decisions in the future. The GAO found that this mechanism (post-investment analysis) was not adequately implemented by the services because there is no formal DoD requirement to do so. According to the GAO, the DoD guidance only states that records must be maintained so that a post-investment analysis can be performed. The GAO reported the following:

- the Navy activities had not performed any post-investment analyses because they were not required;
- the Air Force had not performed any post-investment analyses prior to 1987, because it viewed them as manpower intensive and of questionable benefit; and
- Although Army activities performed post-investment analyses, those analyses have shown that many project benefits were overstated because of optimistic work load projections.

The GAO concluded, therefore, that neither the DoD nor the Services know what benefits the ACP has produced. (p. 4, pp. 56-60/GAO Draft Report)

**DoD Response:** Partially concur. Post-investment analyses have generally not been conducted during the short history of the Asset Capitalization Program. However, in the last 2 years, Service budget exhibits have displayed cost savings resulting from the program. Since these exhibits reflect monetary benefits of the program, the GAO statement that neither the DoD nor the Services know what benefits the ACP has produced is misleading.

● **FINDING K: Internal Controls: Depreciation Records are Inaccurate.** The GAO found that each of the activities it visited, with the exception of the Watervliet Army Arsenal, had several ACP projects that were either not depreciated or depreciated inaccurately. The GAO identified 21 projects costing \$16.1 million that were not being depreciated. The GAO reported that, in most of these cases, the equipment had been used for several months. The GAO also identified 45 projects costing \$11.7 million that were depreciated inaccurately because (1) projects were depreciated at incorrect values or (2) depreciation expenses were recorded late. The GAO concluded that, as a result, the rates charged by activities to their customers were (in some cases) overstated or understated. The

Now on pp. 2-4, 33-34.

Now on pp. 2, 4, 37-38,  
and 40.

GAO attributed these problems to the lack of, or inadequate procedures at, Command or activity levels or a failure by the activities to follow procedures. The GAO referred to prior Army Audit Agency and Air Force Inspector General reports that had identified the same problems in properly accounting for depreciation. (p. 5, pp. 63-65/GAO Draft Report)

**DoD Response:** Concur

● **FINDING L: Internal Controls: Property Inventory Records are Inaccurate.** The GAO discussed the requirement for activities to maintain property records for the inventory for which they are accountable to safeguard against potential theft, damage, or loss of valuable resources. The GAO found that three activities it reviewed did not list several equipment items on the inventory or property control records. The GAO pointed out that some of the unrecorded items had been used for some time. The GAO concluded that, as a result, property inventory records are inaccurate.

(p. 5, pp. 65-67/GAO Draft Report)

**DoD Response:** Concur

Now on pp. 2, 4, 39,  
and 41.

● **FINDING M: Internal Controls: Project Files Are Incomplete.** The GAO described internal control standards that require written evidence of all pertinent aspects of transactions of an agency. The GAO observed that this documentation should be complete and accurate and should trace the transaction and related information from when it is anticipated, while it is in process, and after it is completed. The GAO concluded that this standard is essential to managers in analyzing their operations. The GAO found, however, that many project files did not have complete information on the history of each project and some required documents were missing, incomplete, or undated. The GAO also observed instances where documents were unsigned, which led the GAO to question whether these documents were submitted for review and approval by the responsible organizations. The GAO concluded that the project files were incomplete because the activities either lacked specific guidance on what documentation needed to be in the files or had inadequate guidance. The GAO explained that the DOD guidance is general and states that the basis for capital equipment purchases must be adequately documented at the activity level so that post-investment analyses and audits can be performed. The GAO reported that the Departments of the Army and the Navy had not developed specific guidance on the kind of information to maintain in project files and while the Air Force had developed guidance, the GAO found that it was confusing. (p. 5, pp. 67-69/GAO Draft Report)

**DoD Response:** Concur

Now on pp. 2, 4, 39,  
and 41.

● **FINDING N: Nondiscretionary Project Purchases Reduce Activity Buys.** The GAO explained that, although activities have some discretion in spending their annual fund allocation,

Now on pp. 2, 4, 42-44,  
and 48.

activities must also fund many nondiscretionary purchases. The GAO reported that the amount of nondiscretionary obligations at the seven activities that the GAO visited increased from about \$3.5 million in FY 1983 to about \$23.2 million in FY 1987. According to the GAO, officials at the Red River Army Depot, Mare Island Naval Shipyard, and Sacramento Air Logistics Center indicated that their discretionary buying power has been impacted by (1) the increasing number of non-discretionary projects which receive higher funding priority, and (2) congressionally mandated budget reductions. The GAO concluded that, if ACP continues to be a target for additional budget reductions and non-discretionary requirements continue to receive higher priority funding, discretionary buying power will not improve. (p. 5, pp. 72-75/GAO Draft Report)

**DoD Response:** Partially Concur. While industrial fund activities do not create all ACP item proposals on their own, uniform guidelines must be used for project selection. Even if command or headquarters personnel participate in the selection of a project, the project must be necessary for the activity to fulfill its mission or it must have priority because of its economic justification. A net reduction in discretionary ACP authority at the activity level is not necessarily negative if directions provided by command and headquarters levels result in increased commonality, compatibility, and efficiency among the various industrial fund activities.

For example, the Air Force Logistics Command has undertaken a command-wide initiative to develop and implement a Depot Maintenance Management Information System. If this effort were not controlled at the command level, the Air Force would be subject to justifiable criticism for permitting each Air Logistics Center to develop unique solutions or systems in response to a common problem because the overall cost of multiple unique systems is going to exceed the cost of a common system.

● **FINDING O: Program Affected By Need To Obligate Funds Within Budget Execution Year.** The GAO observed that under the ACP, the activities can carry unobligated equipment funds forward until they are spent. The GAO noted DoD guidance requires activities to request ACP funds for the amounts that are to be obligated in the budget execution year and that commands obligation rates are one determinant of the appropriateness of ACP budget allocation. The GAO concluded that the Services perceived this to mean that ACP funds were expected to be obligated within the budget execution year or the funds would be lost, and this interpretation was communicated to commands and activities. The GAO found that, to avoid losing budget allocations, some activities substituted lower priority items for higher priority items because they were more readily available from commercial sources. (p. 5, pp. 75-81/GAO Draft Report)

Now on pp. 2, 4, 44-47,  
and 48.

**DoD Response:** Concur

● **FINDING P: Limited Visibility Over Large Nondiscretionary Purchases.** The GAO reported that, because of concerns over the visibility of the program, in FY 1987, the House Appropriations Committee required the Secretary of Defense annually to provide information on projects with its budget submission. The GAO noted that the report submitted to the Congress covers a three fiscal year period that includes the past, current, and budget year. The GAO found that the data in the report did not reflect the total cost of larger Service- or command-directed projects over their expected lifetime. For example, the GAO described the procurement lifetime of the Air Force depot maintenance management information system is at least 10 years, with an estimated cost of about \$275 million. According to the GAO, the report to the Congress only identified \$51 million for this system. (p. 6, pp. 81-84/GAO Draft Report)

Now on pp. 2, 4, and 47-49.

**DoD Response:** Partially Concur. Most Asset Capitalization Program projects are annual procurements to satisfy specific requirements. It is not the intent of the Department of Defense to understate total project costs in its communications with the Congress. The Department of Defense is complying with established budget procedures which have been agreed to by the Congress.

In several cases, the total costs of larger multiyear projects are being reported to the Congress in separate reports. For example, the total program costs for the Navy Computer Aided Design 2 and Engineering Data Management Information and Control Systems are reported to Congress in the Information Technology Budget exhibits; and the Air Force Logistics Command's Depot Maintenance Management Information System is the subject of full disclosure reports which are submitted to the House Appropriations Committee staff each quarter.

\* \* \* \* \*

RECOMMENDATIONS

● **RECOMMENDATION 1:** The GAO recommended that the Secretary of Defense require that ACP funds should be used for items that contribute most significantly toward fulfilling the mission of activities. (p. 6, pp. 36-37/GAO Draft Report)

Now on pp. 5, 22.

**DoD Response:** Partially Concur. Although it is agreed that emphasis should be placed on the acquisition of equipment used in the direct mission of the activities, the use of ACP funds for the purchase of items that are used in support of those processes must also be authorized.

Appendix I  
Comments From the Department of Defense

As indicated in the DoD response to Finding B, management information systems have the potential to improve the utilization of resources, the scheduling of work load, material control and productivity. In addition, automated systems for management, personnel and financial information are necessary to the maintenance of economy and efficiency in the activities' overhead areas. This results in lower costs to customers and makes a direct contribution to the industrial fund's mission. ADP acquisitions, including computer-aided design and computer-assisted manufacturing systems and software maintenance tools are extremely beneficial to mission accomplishment.

For industrial fund activities not engaged in the repair or manufacture of items (such as Navy Public Works Centers), continued use of Asset Capitalization Funds for the acquisition of support equipment such as vehicles should be permitted.

By the fourth quarter of calendar year 1989, the Office of the Secretary of Defense can be expected to advise the appropriate DoD components of the need to place additional emphasis on the use of Asset Capitalization Program funds for the acquisition of equipment used in the accomplishment of the direct missions of industrial fund activities.

● **RECOMMENDATION 2:** The GAO recommended that the Secretary of Defense clarify existing guidance on vehicles and what constitutes a unit in determining an item's unit cost. (p. 6, pp. 37/GAO Draft Report)

**DoD Response:** Nonconcur. The FY 1983 conference committee report of the Committees on Appropriations simply precluded the use of ACP funds for the acquisition of general purpose passenger vehicles. Although a more restrictive interpretation may have been revealed in informal communications from one of those committees to representatives of the Department of the Army, congressional intent itself is not clear. Without further clarification of congressional intent, the Department of Defense is not in a good position to provide revised guidance. As explained below, the application of more restrictive guidance to industrial fund activities that have a bona fide need for vehicles in order to the accomplish their missions could result in increased costs to the Government.

It is considered appropriate that industrial fund activities be authorized to use ACP funds for the purchase of vehicles when those vehicles otherwise meet the criteria for ACP purchases and are used in the accomplishment of the activities' primary missions. The exercise of other options, such as leasing of vehicles, may prove to be more costly to the activity, its customers, and ultimately the Government.

The Department of Defense also does not concur with the recommendation to clarify what constitutes a unit in determining an item's unit cost. The DoD follows the Governmentwide

Now on p. 22.

See comment 4.

Now on pp. 5, 35.

**DoD Response:** Concur. The Department of the Army will direct that industrial fund activities and commands assign sufficient personnel to the management and oversight of the ACP to ensure that all guidance is followed and that proper review and analysis is conducted. Appropriate guidance can be expected by the second quarter of calendar year 1990.

- **RECOMMENDATION 7:** The GAO recommended that the Secretary of the Navy direct commands to comply with existing guidance to insure that capital investments are consistent with the activities' strategic plans, projects are implemented in a timely manner, and post-investment analyses are being performed. (p. 6, pp. 61/GAO Draft Report)

**DoD Response:** Concur. Existing guidance will be reinforced and post-investment analyses or other measures will be directed on selected projects. The Department of the Navy can be expected to issue guidance by the first quarter of calendar year 1990.

Now on p. 35.

- **RECOMMENDATION 8:** The GAO recommended that the Secretary of the Navy direct commands to assign sufficient personnel to manage and execute the program. (p. 6, pp. 61/GAO Draft Report)

**DoD Response:** Concur. The Department of the Navy will direct that industrial fund activities and commands assign sufficient personnel to the management and oversight of the ACP to ensure that all guidance is followed and that proper review and analysis is conducted. Appropriate guidance can be expected by the second quarter of calendar year 1990.

Now on pp. 5, 35.

- **RECOMMENDATION 9:** The GAO recommended that the Secretary of the Air Force direct commands to comply with existing guidance to insure that capital investments are consistent with the activities' strategic plans, projects are implemented in a timely manner, and post-investment analyses are being performed. (p. 6, pp. 61/GAO Draft Report)

**DoD Response:** Concur. The Department of the Air Force can be expected to direct compliance with existing guidance by the first quarter of calendar year 1990.

Now on p. 35.

- **RECOMMENDATION 10:** The GAO recommended that the Secretary of the Air Force direct commands to assign sufficient personnel to manage and execute the program. (p. 6, pp. 61/GAO Draft Report)

**DoD Response:** Concur. The Department of the Air Force will direct that industrial fund activities and commands assign sufficient personnel to the management and oversight of the ACP to ensure that all guidance is followed and that proper review and analysis is conducted. Appropriate guidance can be expected by the second quarter of calendar year 1990.

- **RECOMMENDATION 11:** The GAO recommended that the Secretary of Defense develop guidance on the minimum documentation required

Appendix I  
Comments From the Department of Defense

Now on p. 35.

to be maintained in ACP project files. (p. 6, pp. 69/GAO Draft Report)

**DoD Response:** Partially concur. Documentation already required to be incorporated in files maintained by military contracting offices should not be duplicated in separate ACP project files. The Office of the Secretary of Defense will provide appropriate guidance relative to the maintenance of minimal documentation. A system of cross-referencing contract files to ACP project files will be established if necessary. Such guidance can be expected by the fourth quarter of calendar year 1989.

Now on pp. 5, 35.

● **RECOMMENDATION 12:** The GAO recommended that the Secretary of the Army direct commands to (1) comply with existing internal control procedures, (2) develop procedures to verify that actual costs of equipment is recorded on depreciation and plant property records, and (3) followup to ensure internal control procedures are being followed. (p. 6, pp. 69-70/GAO Draft Report)

**DoD Response:** Concur. Existing Army directives will be reviewed and revised as necessary to (1) assure compliance with existing internal control procedures, (2) verify that actual costs of equipment are recorded on depreciation and plant property records, and (3) followup to ensure that internal control procedures are being followed. Appropriate guidance can be expected by the first quarter of calendar 1990.

Now on pp. 5, 35.

● **RECOMMENDATION 13:** The GAO recommended that the Secretary of the Navy direct commands to (1) comply with existing internal control procedures, (2) develop procedures to verify that actual costs of equipment is recorded on depreciation and plant property records, and (3) followup to ensure internal control procedures are being followed. (p. 6, pp. 69-70/GAO Draft Report)

**DoD Response:** Concur. Existing Navy directives will be reviewed and revised as necessary to (1) assure compliance with existing internal control procedures, (2) verify that actual costs of equipment are recorded on depreciation and plant property records, and (3) followup to ensure that internal control procedures are being followed. Appropriate guidance can be expected by the first quarter of calendar 1990.

Now on pp. 5, 35.

● **RECOMMENDATION 14:** The GAO recommended that the Secretary of the Air Force direct commands to (1) comply with existing internal control procedures, (2) develop procedures to verify that actual costs of equipment is recorded on depreciation and plant property records, and (3) followup to ensure internal control procedures are being followed. (p. 6, pp. 69-70/GAO Draft Report)

**DoD Response:** Concur. Existing Air Force directives will be reviewed and revised as necessary to (1) assure compliance with

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The following are GAO's additional comments on DOD's letter dated May 18, 1989.

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## GAO Comments

1. After considering DOD's comments, we deleted our reference to vehicle purchases made by the Naval Facilities Engineering Command.
2. Current DOD accounting guidance on what equipment purchases are to be capitalized versus expensed was adequate. However, in the case of the Army's planned purchase of computers for its Standard Army Management Information Systems, this guidance was inappropriately applied. We subsequently found that the Army's planned purchase did not materialize and, therefore, our example demonstrating inconsistent application of the DOD guidance was no longer applicable. As a result, we have deleted this section from the report.
3. We revised this section to recognize that some guidance was provided by the Office of the Secretary of Defense, the services, and the commands.
4. Recommendation deleted based on comment 2.
5. In response to our draft report, on July 5, 1989, DOD established functional program management responsibility within the Office of the Assistant Secretary of Defense (Production and Logistics). We therefore have deleted this recommendation.

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